

Diploma in International Financial Reporting

Practice & Revision Kit

BPP Learning Media is an **ACCA Approved Content Provider** for the DipIFR qualification. This means we work closely with ACCA to ensure our products fully prepare you for your DipIFR exams.

In this Practice & Revision Kit, which has been reviewed by the **DipIFR examining team**:

- We discuss the **best strategies** for revising and taking your DipIFR exam
- We show you how to be **well prepared** for your exam
- We give you **lots of great guidance** on tackling questions
- We provide you with **three** mock exams including the **December 2017 exam**

Our **Passcards** also support this qualification.

FOR EXAMS IN DECEMBER 2018 AND JUNE 2019

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Using your BPP Learning Media products

This Practice & Revision Kit gives you the question practice and guidance you need in the exam.

As an ACCA **Approved Content Provider**, BPP Learning Media gives you the **opportunity** to use revision materials reviewed by the ACCA examining team. By incorporating the examining team's comments and suggestions regarding the depth and breadth of syllabus coverage, the BPP Learning Media Practice and Revision Kit provides excellent, **ACCA-approved** support for your studies.

These materials are reviewed by the ACCA examining team. The objective of the review is to ensure that the material properly covers the syllabus and study guide outcomes, used by the examining team in setting the exams, in the appropriate breadth and depth. The review does not ensure that every eventuality, combination or application of examinable topics is addressed by the ACCA Approved Content. Nor does the review comprise a detailed technical check of the content as the Approved Content Provider has its own quality assurance processes in place in this respect.

Our other products can also help you pass:

- The **Study Text** outlines the content of the qualification, the necessary skills the examining team expect you to demonstrate and any assumed prior knowledge and is completely focused on helping you pass the exam.
- **Passcards** provide you with clear topic summaries and exam tips.

You can purchase these products by visiting www.bpp.com/learningmedia

Question and Answer checklist/index

The headings in this index indicate the main topics of questions, but questions often cover several different topics.

Questions set under the older-style DipIFR exams are included because their style and content are similar to that of the current exam, although they may differ in length. These questions are marked with an asterisk (*) below.

	Marks	Time allocation Mins	Page number Question	Page number Answer
Part A: International sources of authority				
Regulatory and conceptual framework				
1 Omega 15 (12/11)	20	39	3	81
2 Users*	12	25	3	82
Part B: Elements of financial statements				
Revenue				
3 Mocca	20	39	4	83
4 Delta (12/14)	20	39	5	84
5 Kolya (12/15)	20	39	5	87
Tangible non-current assets				
6 Shiplake	20	39	6	89
7 Cash generating units*	15	29	7	90
8 Omikron	20	39	8	91
9 Omega 1 (12/06)	20	39	8	92
10 Omega 10 (6/10)	20	39	9	94
Accounting for leases				
11 Leases	20	39	11	96
12 Grimble Co	20	39	11	98
13 Delta (6/15) (amended)	20	39	12	100
14 Dougal (12/15)	20	39	13	102
Intangible assets and goodwill				
15 Dexterity	20	39	14	104
16 Darby	20	39	15	106
17 Lambda 2 (6/11)	20	39	16	108
18 Myriad and Epsilon	20	39	17	109

	Marks	Time allocation Mins	Page number Question	Answer
Provisions and contingencies				
19 Worldwide Nuclear Fuels	20	39	18	111
20 Epsilon 7 (12/08) (amended)	20	39	19	112
21 Delta 2 (6/12) (amended)	20	39	20	115
Employee benefits				
22 Kappa 4 (6/09)	20	39	21	117
23 Omicron 2 (12/11)	20	39	22	118
Financial instruments				
24 Avco	20	39	23	120
25 Seltec and Kappa	20	39	23	122
26 Delta (12/12) (amended)	20	39	24	124
27 Ontario (6/16)	20	39	25	127
Accounting for taxation				
28 Kappa (12/13)	20	39	25	129
29 Epsilon (6/14)	20	39	26	130
30 Edgworth (6/16)	20	39	27	132
Foreign currency transactions				
31 Delta (6/13) (amended)	20	39	29	134
32 Omega (6/14)	20	39	29	136
Other assets: agriculture, mineral resources and inventories				
33 Agriculture	20	39	30	137
34 Omega 6 (12/09) (amended)	15	29	31	139
35 Omega (6/15)	20	39	32	140
36 Okawa (12/15)	20	39	33	142
Share-based payment				
37 Lambda (12/09)	20	39	33	143
38 Omega 14 (6/11) (amended)	20	39	34	144
39 Delta (6/14) (amended)	20	39	35	147
40 Kappa (6/15)	20	39	36	149
41 Roma (6/16)	20	39	38	151

	Marks	Time allocation Mins	Page number Question	Answer
Part C: Presentation and additional disclosures				
Reporting financial performance				
42 Epsilon 11 (6/12)	20	39	39	153
43 Beloso Co	20	39	40	154
44 Epsilon 3 (12/05)	20	39	40	156
45 Omega 11 (2011 Pilot Exam)	20	39	41	157
46 Delta (12/13) (amended)	20	39	42	159
Earnings per share				
47 Kappa 6 (12/10)	20	39	43	161
48 Townsend	20	39	44	163
Related party disclosures and segment reporting				
49 RP Group	20	39	45	165
50 Omega (6/13)	20	39	45	166
51 Omega (12/14)	20	39	46	168
Small and medium-sized entities				
52 Whitebirk	20	39	47	170
Part D: Preparation of external financial reports for combined entities and joint arrangements				
Consolidated statement of financial position				
53 Alpha Group 10 (6/12)	40	78	47	172
54 Alpha (6/13)	40	78	50	175
55 Alpha Group (12/13)	40	78	53	180
56 Epsilon (12/14)	20	39	56	184
57 Alpha (6/15)	40	78	57	185
58 Ayre (12/15)	40	78	60	189
Consolidated statement of profit or loss and other comprehensive income				
59 Alpha Group 8 (2011 Pilot Exam) (amended)	40	78	62	194
60 Alpha, Beta, Gamma (6/11) (amended)	40	78	65	197
61 Alpha (12/12) (amended)	40	78	67	201
62 Alpha Group (6/14) (amended)	40	78	70	205
63 Alpha Group (12/14) (amended)	40	78	73	208
64 Abiola (6/16)	40	78	76	212
Exam Practice				
Mock Exam 1 (December 2016 exam)	100	195	219	227
Mock Exam 2 (June 2017 exam)	100	195	243	251
Mock Exam 3 (December 2017 exam)	100	195	265	273

Effective revision

What you must remember

Effective use of time as you approach the exam is very important. You must remember:

Believe in yourself

Use time sensibly

Believe in yourself

Are you cultivating the right attitude of mind? There is absolutely no reason why you should not pass this **exam** if you adopt the correct approach.

- **Be confident** – you've passed exams before, you can pass them again
- **Be calm** – plenty of adrenaline but no panicking
- **Be focused** – commit yourself to passing the exam

Use time sensibly

- 1 **How much study time do you have?** Remember that you must **eat, sleep**, and of course, **relax**.
- 2 **How will you split that available time between each subject?** A **revision timetable**, covering **what** and **how** you will revise, will help you organise your revision thoroughly.
- 3 **What is your learning style?** AM/PM? Little and often/long sessions? Evenings/weekends?
- 4 **Do you have quality study time?** Unplug the phone. Let everybody know that you're studying and shouldn't be disturbed.
- 5 **Are you taking regular breaks?** Most people absorb more if they do not attempt to study for long uninterrupted periods of time. A five minute break every hour (to make coffee, watch the news headlines) can make all the difference.
- 6 **Are you rewarding yourself for your hard work?** Are you leading a **healthy lifestyle**?

What to revise

Key topics

You need to spend most time on, and practise full questions on, **key topics**.

Key topics

- Recur regularly
- Underpin whole exam
- Discussed currently in press
- Covered in recent articles by examining team
- Shown as high priority in study material

Difficult areas

You may also still find certain areas of the syllabus difficult.

Difficult areas

- Areas you find dull or pointless
- Subjects you highlighted as difficult when taking notes
- Topics that gave you problems when you answered questions or reviewed the material

DON'T become depressed about these areas; instead do something about them.

- Build up your knowledge by **quick tests** such as the quick quizzes in your BPP Learning Media Study Text.
- Work carefully through **numerical examples** and **questions** in the BPP Study Text for exams in December 2018 and June 2019, and refer back to the Study Text if you struggle with computations in the Practice & Revision Kit.
- **Note down weaknesses** that your answers to questions contained; you are less likely to make the same mistakes if you highlight where you went wrong.

Breadth of revision

Make sure your revision has sufficient **breadth**. Given that all questions are compulsory, you need to be prepared for anything. There are also regular questions on what you may consider to be peripheral areas, eg IAS 41, IFRS 6, so you must know the entire syllabus.

DipIFR

In this exam do not spend all your revision practising the numerical techniques. Past exams include computational and discursive elements.

How to revise

There are four main ways that you can revise a topic area.

Write it!

Read it!

Teach it!

Do it!

Write it!

The Study Text is too bulky for revision. You need a slimmed down set of notes that summarise the key points. Writing important points down will help you recall them, particularly if your notes are presented in a way that makes it easy for you to remember them.

Read it!

You should read your notes actively, testing yourself by doing quick quizzes or Practice & Revision Kit questions while you are reading.

Teach it!

Exams require you to show your understanding. Teaching what you are revising to another person helps you practise explaining topics. Teaching someone who will challenge your understanding, someone for example who will be taking the same exam as you, can help both of you.

Do it!

Remember that you are revising in order to be able to answer questions in the exam. Answering questions will help you practise **technique** and **discipline**, which the examining team emphasise over and over again can be crucial in passing or failing exams.

- 1 Start with any **preparation questions** included for the syllabus area. These provide you with a firm foundation from which to attempt exam-standard questions.
- 2 The more exam-standard questions you do, the more likely you are to pass the exam.
- 3 You should produce **full answers** under **timed conditions**, and don't cheat by looking at the answer! If you are struggling, look back at your notes or the BPP Study Text; also read the guidance attached to certain questions and the questions with analysis. Produce answer plans if you are running short of time.
- 4 Always read the **guidance** in the answers. It's there to help you, and will show you which points in the answer are the most important. In particular, see how you could have gained **easy marks** on the question. Also study carefully the guidance accompanying the answers to the questions with analysis, and the commentary provided with the student answers.
- 5 **Don't get despondent** if you didn't do very well. Be sure to try another question that covers the same subject.

The exam

For DipIFR, all questions are compulsory – there are no optional questions.

The duration of the exam is 3 hours and 15 minutes. The exam format is as follows:

- **One 40 mark question** covering group accounting and individual company adjustments.
- **Three 20 mark questions** covering a variety of accounting standards.

An individual question may often involve elements that relate to different areas of the syllabus. For example, a question on the preparation of financial statements for public issue could include elements relating to several accounting standards. In a scenario question candidates may be expected to comment on management's chosen accounting treatment and determine a more appropriate one, based on circumstances described in this question.

Some International Financial Reporting Standards are very detailed and complex. In the DipIFR exam candidates need to be aware of the principles and key elements of these Standards. Candidates will also be expected to have an appreciation of the background and need for international financial reporting standards and issues related to harmonisation of accounting in a global context.

Format of the exam

	<i>Number of marks</i>
One consolidation question	40
Three scenario questions	60
	<u>100</u>

Additional information

ACCA has an annual cut off rule when deciding what comprises an examinable document which could be used as part of an exam. Knowledge of new examinable regulations issued by 1 September will be required in examination sessions being held in the following calendar year. Documents may be examinable even if the effective date is in the future.

The Study Guide provides more detailed guidance on the depth and level at which the examinable documents will be examined. Examinable documents are listed on ACCA's website at: www.accaglobal.com/gb/en/student/exam-support-resources/dipifr-study-resources/dipifr-examinable-documents.html

Analysis of past exams

December 2017

- 1 Preparation of a consolidated statement of financial position for an entity with two subsidiaries, involving accounting for investments classified as fair value through profit or loss, equity-settled share-based payment and a long-term convertible loan.
- 2 Explanation of the accounting treatment of two issues: a defined benefit scheme and the construction of an asset with a potential decommissioning liability.
- 3 Explanation and application of IFRS 16 *Leases*.
- 4 Explanation of four issues: differing accounting treatment of two equity investments; accounting treatment of a revaluation of a property portfolio including tax implications; consolidation of a subsidiary with a different year end to the parent; and related party disclosures.



June 2017

- 1 Calculation of goodwill on acquisition of two subsidiaries, and the preparation of a consolidated statement of profit or loss and other comprehensive income and consolidated statement of changes in equity. Adjustments included impairment of goodwill, fair value uplifts on acquisition, a decommissioning provision and a cash flow hedge.
- 2 Explanation of the accounting treatment of three issues: a finance lease (lessor), joint arrangement and impairment of a financial asset.
- 3 Explanation of current vs non-current assets and tangible vs intangible assets. Explanation of the accounting for a partly owner-occupied investment property and an intangible asset.
- 4 Explanation of three issues: first time adoption of IFRSs, measurement of financial assets, and equity-settled share-based payment scheme.

December 2016

- 1 Preparation of a consolidated statement of financial position, involving fair value adjustments to PPE, deferred tax on those adjustments, an unrecognised contingent liability, impairment of goodwill, contingent consideration and a provision for the restoration of land.
- 2 Explain and show the treatment of three issues: a finance lease (lessor), sale of a product with a right of return, cash settled share-based payment.
- 3 Explanation and application of IFRS 9, specifically financial assets.
- 4 Explanation of four issues: related parties, treatment of tangible non-current assets including investment property, treatment of research and development expenditure, and reporting requirements of listed versus unlisted entities.

June 2016

- 1 Preparation of consolidated statement of profit or loss and other comprehensive income and summarised statement of changes in equity. Adjustments for impairment of goodwill; acquisition of subsidiary during the year; issue of a convertible bond.
- 2 Explain and show the treatment of three issues: equity-settled share options, provisions and contingent assets and related parties.
- 3 Explanation and application of IAS 12.
- 4 Explanation of three issues: impairment of financial instruments, recognition of biological assets and changes in accounting policies and estimates.

December 2015

- 1 Preparation of consolidated statement of financial position. Adjustments for impairment of goodwill; intra-group trading; decommissioning provision; financial instruments. Discussion on application of IFRS 10.
- 2 Explain and show the treatment of: investment property with change of use; foreign currency translation; and share-based payments.
- 3 Explanation and application of IFRS 15.
- 4 Explanation of two issues: exploration for and evaluation of mineral resources and non-current assets held for sale.

June 2015

- 1 Preparation of consolidated statement of financial position. Adjustments for intra-group trading; restructuring provision; convertible loan.
- 2 Explain and illustrate the treatment of derivative (share options); leaseback agreement; and events after the reporting date.
- 3 Explanation of principles and application of IFRS 2 on share-based payments.
- 4 Explanation of two issues: accounting for agriculture and reporting for small and medium-sized entities.

December 2014

- 1 Preparation of consolidated statement of profit or loss and other comprehensive income and summarised consolidated statement of changes in equity, including the acquisition of a subsidiary. Adjustments for impairment of goodwill; intra-group trading; post-employment benefits; redundancy and reorganisation costs; an issue of convertible bonds; and a forward currency contract.
- 2 Explain and show the treatment of: the sale of a machine including post-sale maintenance; the construction of a factory on a leased piece of land; and a provision.
- 3 Definition of control and explanation of calculation and treatment of goodwill; computation of goodwill.
- 4 Explanation of three issues: operating segments; equity-settled share-based payments; and non-current assets held for sale.

June 2014

- 1 Discussion of the status of an investment acquired during the year (associate or subsidiary). Preparation of consolidated statement of profit or loss and other comprehensive income including acquisition of a subsidiary. Adjustments for impairment of goodwill; intra-group trading; defined benefit pension plan; revaluation of property; hedge of a future property purchase.
- 2 Explain and illustrate the treatment of share appreciation rights; sale and repurchase agreement; and an operating lease.
- 3 Explanation of principles and requirements of IAS 12 *Income Taxes*; application to five specific scenarios – a tax loss, a disallowable provision, capitalised development costs, impairment of goodwill and a zero-coupon loan.
- 4 Explanation of three issues: a related party relationship and required disclosures; whether advertising costs can be recognised as an intangible asset; and the treatment of foreign exchange gains and losses.

December 2013

- 1 Preparation of consolidated statement of financial position including acquisition of a subsidiary. Adjustments for fair value adjustments; joint operation; revalued land; development costs; intercompany trading; forward currency contract; long-term borrowings.
- 2 Explanations on financial instruments (financial asset); held for sale business unit; sale and leaseback.
- 3 Discussion of tax base and the IAS 12 recognition and disclosure requirements; application to three specific scenarios – revaluation of an investment, unrealised profit on an intra-group sale, and revenue received in advance taxed on a receipts basis.
- 4 Computation of the carrying value of a complex non-current asset; analysis of an equity settled share based payment.

June 2013

- 1 Preparation of consolidated statement of financial position for a group that includes a subsidiary and an associate. Adjustments for fair value on acquisition of subsidiary, share-based payment, provisions and borrowings.
- 2 Explain and show the financial reporting treatment of issue of foreign currency debt; construction of an asset, and; leases.
- 3 Knowledge of IAS 18 *Revenue Recognition*; explain and show the reporting of four transactions.
- 4 Explanation of fair value and IFRS 13 *Fair Value Measurement*; explanation of segment reporting – identification of segments.

December 2012

- 1 Preparation of consolidated statement of comprehensive income including acquisition of a subsidiary. Adjustments for acquisition costs; goodwill impairment; non-controlling interest; joint arrangement and foreign currency financial instrument.
- 2 Explanations on financial asset; depreciation on complex assets and financial reporting treatment of accounting errors; contingent liabilities and contingent assets.
- 3 IAS 18 *Revenue*.
- 4 Financial reporting treatment of an asset held for sale, operating leases and a self constructed asset.

Exam technique

Passing professional examinations is half about having the knowledge, and half about doing yourself full justice in the examination. You must have the right approach at the following times.

Before the exam Your time in the exam hall

Before the exam

- 1 Set at least one **alarm** (or get an alarm call) for a morning exam.
- 2 Have **something to eat** but beware of eating too much; you may feel sleepy if your system is digesting a large meal.
- 3 Allow plenty of **time to get to the exam hall**; have your route worked out in advance and listen to news bulletins to check for potential travel problems.
- 4 **Don't forget** pens, pencils, rulers, erasers, watch. Also make sure you remember **entrance documentation** and **evidence of identity**.
- 5 Put **new batteries** into your calculator and take a spare set (or a spare calculator).
- 6 **Avoid discussion** about the exam with other candidates outside the exam hall.

Your time in the exam hall

- 1 **Read the instructions (the 'rubric') on the front of the exam carefully**

Make sure that you are comfortable with the new exam format. Examining team reports often remark on the number of students who attempt too few – or too many – questions, or who attempt the wrong number of questions from different parts of the exam.

- 2 **Plan your attack carefully**

Consider the **order** in which you are going to tackle questions. It is a good idea to start with your best question to boost your morale and get some easy marks 'in the bag'.

- 3 **Check the time allocation for each question**

Each mark carries with it a **time allocation** of 1.95 minutes (including time for selecting and reading questions, and checking answers). A 20-mark question therefore should be selected, completed and checked in 39 minutes. When the time for that question has run out, you **must** go on to the next question or question part. Going even one minute over the time allowed brings you a lot closer to not passing the exam.

- 4 **Read the question carefully and plan your answer**

Read through the question again very carefully when you come to answer it. Remember what you've learnt about approaching questions in this exam. Plan your answer taking into account how the answer should be **structured**, what the **format** should be and **how long** it should take.

Confirm before you start writing that your plan makes **sense**, covers **all relevant points** and does not include **irrelevant material**. Two minutes of planning plus eight minutes of writing is virtually certain to earn you more marks than ten minutes of writing.

5 Answer the question set

Particularly with written answers, make sure you **answer the question set**, and not the question you would have preferred to have been set.

6 Gain the easy marks

Include the obvious if it answers the question and don't try to produce the perfect answer. Remember the guidance you've seen in this Practice & Revision Kit.

Don't get bogged down in small parts of questions. If you find a part of a question difficult, get on with the rest of the question. If you are having problems with something, the chances are that everyone else is too.

7 Produce an answer in the correct format

The examining team will **state in the requirements** the format in which the question should be answered, for example in a report or memorandum.

8 Follow the examining team's instructions

You will **annoy** the examining team if you ignore them.

9 Lay out your numerical computations and use workings correctly

Make sure the layout fits the **type of question** and is in a style the examining team likes. Show all your **workings** clearly and explain what they mean. **Cross reference** them to your solution. This will help the examining team to follow your method (this is of particular importance where there may be several possible answers).

10 Present a tidy script

You are a professional, and it should show in the **presentation of your work**. Students are penalised for poor presentation and so you should make sure that you write legibly, label diagrams clearly and lay out your work neatly. Markers of scripts each have hundreds of scripts to mark; it is more difficult to mark a script which has been poorly written and it is unlikely to receive the same attention as a neat and well laid out script.

11 Stay until the end of the exam

Use any spare time **checking and rechecking** your script. This includes checking that

- You have **filled out** the **candidate details correctly**.
- Question parts and workings are **labelled clearly**.
- Aids to navigation such as **headers and underlining** are used effectively.
- **Spelling, grammar and arithmetic** are correct.

12 Don't discuss an exam with other candidates afterwards

There's nothing more you can do about it so why discuss it?

13 Don't worry if you feel you have performed badly in the exam

It is more than likely that the other candidates will have found the exam difficult too. Don't forget that there is a competitive element in these exams. As soon as you get up to leave the exam hall, **forget that exam** and think about the next – or, if it is the last one, celebrate!

Useful websites

The websites below provide additional sources of information of relevance to your studies

- www.accaglobal.com
 ACCA's website. The students' section of the website is invaluable for detailed information about the qualification, past issues of Student Accountant (including technical articles) and interviews with examining teams. It includes a student section. The DiplIFR section is here:
www.accaglobal.com/an/en/student/exam-support-resources.html#
 Alternatively, go to the ACCA homepage (above), then click on Students, then on Diploma in International Financial Reporting.
- www.bpp.com
 Our website provides information about BPP products and services, with a link to the ACCA website.
- www.iasb.org
 News about the activities of the International Accounting Standards Board
- www.ft.com
 This website provides information about current international business. You can search for information and articles on specific industry groups as well as individual companies.
- www.economist.com
 Here you can search for business information on a week-by-week basis, search articles by business subject and use the resources of the Economist Intelligence Unit to research sectors, companies or countries.
- www.investmentweek.co.uk
 This site carries business news and articles on markets from Investment Week and International Investment.
- www.cfo.com
 Good website for financial officers.

Questions

1 Omega 15 (12/11)

39 mins

You are the financial controller of Omega. Omega has subsidiaries located in a number of different countries. Omega has a strategy of growth by acquisition and regularly evaluates potential acquisition targets from different countries and financial reporting regimes. Omega regularly seeks to raise capital on a number of different markets to fund new acquisitions. All subsidiaries currently prepare financial statements using applicable local accounting standards. The consolidated financial statements have been prepared using local accounting standards that apply in Omega's jurisdiction up to and including the year ended 30 September 20X1. Local regulations allow financial statements to be prepared either using local accounting standards or International Financial Reporting Standards (IFRS). The directors are giving serious consideration to using IFRS from the year ending 30 September 20X2 onwards. One of the directors is unsure of the wisdom of this proposal and has identified a number of issues about which he is uncertain.

Issue (a)

Changing from using local standards to using international standards is bound to have short-term cost implications. I need to be convinced that the benefits of a change justify these costs. Please describe three ways we would benefit from a move to IFRS. (6 marks)

Issue (b)

Before I can agree with a move to IFRS I need to understand how the standard setting process works. Someone told me there are four different bodies involved! Please give me a brief description of each one of these, highlighting their role in the standard setting process. (8 marks)

Issue (c)

I'm unclear about the practicalities of adopting IFRS in the year ending 30 September 20X2. I've heard that we need to start with the opening IFRS statement of financial position. I'm unclear what this means and for what date it is prepared. Please explain the process for me, including any additional disclosures we need to make in the first set of financial statements prepared under IFRS. (6 marks)

Required

Prepare a response to the three issues raised by the director.

Note. The mark allocation is shown against each of the three issues above.

(Total = 20 marks)

2 Users

25 mins

The IASB's *Conceptual Framework for Financial Reporting* continues to make the same two mistakes that accountants have made for years.

First, it recognises a wide range of 'users'. They all have differing needs and the end result is bigger and bigger but less comprehensible sets of accounts. The only users that financial accountants should be interested in are the company's shareholders.

Second, it assumes that all shareholders have the same needs when, in reality, they do not. Some want very detailed information in order to carry out a full financial analysis. Most shareholders, however, want a quick summary of the key points.

Unless these problems are addressed, the future of financial accounting looks bleak. More and more information will be produced for users who don't pay for the cost of producing it, whilst the majority of the users who bear these costs just get disaffected and lose interest due to the sheer volume of the information in the accounts.

Required

Discuss and reach a conclusion on the statement above.

(12 marks)



3 Mocca

39 mins

- (a) On 1 March 20X1, Mocca entered into a contract with Reven for the sale of plant for \$500,000. The contract included a call option that gave Mocca the right to repurchase the plant for \$550,000 on or before 27 February 20X2.

Required

Discuss how the above transaction would be treated in the following year's financial statements of Mocca, ie for the year ended 31 March 20X2. (5 marks)

- (b) IFRS 15 *Revenue from Contracts with Customers* deals with accounting requirements for contracts in respect of which performance obligations are satisfied over time.

Required

- (i) Describe the issues of revenue and profit recognition relating to contracts where performance obligations are satisfied over time. (5 marks)

- (ii) On 1 October 20X0 Mocca entered into a contract where performance obligations were deemed to be satisfied over time. The contract was expected to take 27 months and therefore be completed on 31 December 20X2. Details of the contract are:

	\$'000
Total contract revenue	12,500
Estimated total cost of contract (excluding plant)	5,500

Plant for use on the contract was purchased on 1 January 20X1 (three months into the contract as it was not required at the start) at a cost of \$8m. The plant has a four-year life and after two years, when the contract is complete, it will be transferred to another contract at its carrying amount. Annual depreciation is calculated using the straight-line method (assuming a nil residual value) and charged to the contract on a monthly basis at 1/12 of the annual charge.

The correctly reported profit or loss results for the contract for the year ended 31 March 20X1 were:

	\$'000
Revenue recognised	3,500
Contract expenses recognised	(2,660)
Profit recognised	840

Details of the progress of the contract at 31 March 20X2 are:

	\$'000
Contract costs incurred to date (excluding depreciation)	4,800
Agreed value of work completed and invoiced to date	8,125
Total cash received to date (payments on account)	7,725

The percentage of performance obligation satisfied is calculated as the agreed value of work completed as a percentage of the agreed contract price.

Required

Calculate the amounts which would appear in the statement of profit or loss and statement of financial position of Mocca, including the disclosure note of contract assets/liabilities, for the year ended/as at 31 March 20X2 in respect of the above contract. (10 marks)

(Total = 20 marks)



4 Delta (12/14)

39 mins

Delta is an entity which prepares financial statements to 30 September each year. Each year the financial statements are authorised for issue on 30 November. During the year ended 30 September 2014, the following transactions occurred:

- (a) On 1 October 2013, Delta sold a machine to a customer for a total price of \$500,000. Delta invoiced the customer for \$500,000 on 1 October 2013 and the customer made a payment of \$500,000 to Delta on 15 October 2013. The terms of sale included an arrangement that Delta would service and maintain the machine for a four-year period from 1 October 2013. Delta would normally charge an annual fee of \$37,500 for a service and maintenance arrangement of this nature. The normal selling price of the machine without a service and maintenance arrangement was \$450,000. **(9 marks)**
- (b) On 1 October 2013, Delta completed the construction of an ecologically efficient power station at a total construction cost of \$40m. The useful life of the factory at 1 October 2013 was 40 years. Under the terms of the operating licence granted by the Government, Delta is required to dismantle the power station on 30 September 2053 and return the land to its original state. The latest estimated cost of this process, at 30 September 2053 prices, is \$55m. An appropriate discount rate to use in any relevant calculations is 5% per annum. At this discount rate, the present value of \$1 receivable in 40 years is 14.2 cents. **(8 marks)**
- (c) On 5 May 2014, Delta was notified that a customer (Chi) was taking legal action against Delta in respect of financial losses incurred by Chi. Chi alleged that the financial losses were caused due to the supply by Delta of faulty products on 30 November 2013. Delta defended the case but considered, based on the progress of the case up to 30 September 2014, that there was a 75% probability they would have to pay damages of \$20m to the customer. The case was ultimately settled by Delta paying damages of \$18m to Chi on 15 November 2014. **(3 marks)**

Required

Explain and show (where possible by quantifying amounts) how the three events would be accounted for in the financial statements of Delta for the year ended 30 September 2014.

Note. The mark allocation is shown against each of the three events above. You should assume that all transactions described here are material.

(Total = 20 marks)

5 Kolya (12/15)

39 mins

- (a) IFRS 15 *Revenue from Contracts with Customers* was issued in 2014 and replaces the previous international financial reporting standard relating to revenue.

Required

- (i) Identify the five steps which need to be followed by entities when recognising revenue from contracts with a customer.
 - (ii) Explain how IFRS 15 is expected to improve the financial reporting of revenue. **(5 marks)**
- (b) Kolya prepares financial statements to 30 September each year. During the year ended 30 September 20X5, Kolya entered into the following transactions:
 - (i) On 1 September 20X5, Kolya sold a machine to a customer. Kolya also agreed to service the machine for a two-year period from 1 September 20X5 for no additional charge. The total amount payable by the customer for this arrangement was agreed to be:
 - \$800,000, if the customer paid by 31 December 20X5
 - \$810,000, if the customer paid by 31 January 20X6
 - \$820,000, if the customer paid by 28 February 20X6

The directors of Kolya consider that it is highly probable the customer will pay for the products in January 20X6. The stand-alone selling price of the machine was \$700,000 and Kolya would normally expect to receive \$140,000 in consideration for providing two years' servicing of the machine. The alternative amounts receivable are to be treated as variable consideration. (10 marks)

- (ii) On 20 September 20X5, Kolya sold 100 identical items to a customer for \$2,000 each. The items cost Kolya \$1,600 each to manufacture. The terms of sale are that the customer has the right to return the goods for a full refund within three months. After the three-month period has expired the customer can no longer return the goods and payment becomes immediately due. Kolya has entered into transactions of this type with this customer previously and can reliably estimate that 4% of the products are likely to be returned within the three-month period. (5 marks)

Required

Explain and show how both these transactions would be reported in the financial statements of Kolya for the year ended 30 September 20X5.

Note. The mark allocation is shown against both of the two transactions above.

(Total = 20 marks)

6 Shiplake

39 mins

It is generally recognised in practice that non-current assets should not be carried in a statement of financial position at values that are greater than they are 'worth'. In the past there has been little guidance in this area with the result that impairment losses were not recognised on a consistent or timely basis or were not recognised at all. IAS 36 *Impairment of assets* was issued in June 1998 on this topic.

Required

- (a) (i) Define an impairment loss and explain when companies should carry out a review for impairment of assets. (3 marks)
- (ii) Describe the circumstances which may indicate that a company's assets may have become impaired. (7 marks)
- (b) Shiplake is preparing its financial statements to 31 March 20X2. The following situations have been identified by an impairment review team:
- (i) On 1 April 20X1 Shiplake acquired 100% of the ordinary share capital in two subsidiary companies, Halyard and Mainstay, in separate acquisitions. Consolidated goodwill was calculated as:

	<i>Halyard</i>	<i>Mainstay</i>
	\$'000	\$'000
Purchase consideration	12,000	4,500
Estimated fair value of net assets	(8,000)	(3,000)
Consolidated goodwill	<u>4,000</u>	<u>1,500</u>

A review of the fair value of each subsidiary's net assets was undertaken in March 20X2.

Unfortunately both companies' net assets had declined in value. The estimated value of Halyard's net assets as at 1 April 20X1 was now only \$7m. This was due to more detailed information becoming available about the market value of its specialised properties. Mainstay's net assets were estimated to have a fair value of \$500,000 less than their carrying amount. This fall was due to some physical damage occurring to its plant and machinery. (3 marks)

- (ii) Shiplake has an item of earth-moving plant, which is hired out to companies on short-term contracts. Its carrying amount, based on depreciated historical cost, is \$400,000. The estimated selling price of this asset is only \$250,000, with associated selling expenses of \$5,000. A recent review of its value in use based on its forecast future cash flows was estimated at \$500,000. Since this review was undertaken there has been a dramatic increase in interest rates that has significantly increased the cost of capital used by Shiplake to discount the future cash flows of the plant. (3 marks)

- (iii) Shiplake is engaged in a research and development project to produce a new product. In the year to 31 March 20X1 the company spent \$120,000 on research that concluded that there were sufficient grounds to carry the project on to its development stage and a further \$75,000 had been spent on development. At that date management had decided that they were not sufficiently confident in the ultimate profitability of the project and wrote off all the expenditure to date to the statement of profit or loss. In the current year further direct development costs have been incurred of \$80,000 and the development work is now almost complete with only an estimated \$10,000 of costs to be incurred in the future. Production is expected to commence within the next few months. Unfortunately the total trading profit from sales of the new product is not expected to be as good as market research data originally forecast and is estimated at only \$150,000. As the future benefits are greater than the remaining future costs, the project will be completed but, due to the overall deficit expected, the directors have again decided to write off all the development expenditure. (4 marks)

Required

Explain, with numerical illustrations where possible, how the information in (i) to (iii) above would affect the preparation of Shiplake's consolidated financial statements to 31 March 20X2. (10 marks as indicated)

(Total = 20 marks)

7 Cash generating units

29 mins

- (a) IAS 36 *Impairment of Assets* uses the term cash generating units.

Required

Explain what a cash generating unit is and why it is necessary. (5 marks)

- (b) Identify the cash generating unit in the following cases:

- (i) A manufacturer can produce a product at a number of different sites. Not all the sites are used to full capacity and the manufacturer can choose how much to make at each site. However, there is not enough surplus capacity to enable any one site to be closed. The cash inflows generated by any one site therefore depend on the allocation of production across all sites.
- (ii) A restaurant chain has a large number of restaurants across the country. The cash inflows of each restaurant can be individually monitored and sensible allocations of costs to each restaurant can be made. (5 marks)

- (c) M Inc has a single substantial asset, the SyMIX which it uses to manufacture computer chips. The carrying amount of the SyMIX after four years is \$5m (cost \$7m, accumulated depreciation on a straight line basis of \$2m). There is no expected residual value. Due to a breakthrough in technology in the manufacture of computer chips, M Inc now expects the machine to produce 30% less in revenue terms than expected over the rest of its estimated useful life of ten years. Net future cash flows for the next five years, based on management's best estimate after taking the 30% cut into account, are (\$'000):

Year	1	2	3	4	5
Future cash flows	600	660	710	755	790

The expected growth rates for the following years are:

Year	6	7	8	9	10
Future cash flows	2%	(1)%	(7)%	(16)%	(30)%

If the machine was sold now it would realise \$3.2m, net of selling costs. The discount rate to be applied to the future cash flows is 10%.

Required

Calculate any impairment loss and state the new carrying amount of the SyMIX. (5 marks)

(Total = 15 marks)

8 Omikron

39 mins

IAS 36 *Impairment of Assets* requires that where there has been an impairment in the value of an asset, the carrying amount should be written down to the recoverable amount. The phrase 'recoverable amount' is defined as 'the higher of an asset's fair value less costs of disposal and its value in use'.

Required

- (a) (i) Describe the circumstances which indicate that an impairment loss relating to an asset may have occurred. (6 marks)
- (ii) Explain how the IAS 36 deals with the recognition and measurement of the impairment of assets. (7 marks)
- (b) Omikron, a public limited company, has decided to comply with IAS 36 *Impairment of Assets*. The following information is relevant to the impairment review.

Omikron acquired a taxi business on 1 January 20X8 for \$230,000. The values of the assets of the business at that date based on fair value less costs of disposal were as follows.

	\$'000
Vehicles	120
Intangible assets (taxi licence)	30
Trade receivables	10
Cash	50
Trade payables	(20)
	<u>190</u>

On 1 February 20X8, the taxi company had three of its vehicles stolen. The fair value less costs of disposal of these vehicles was \$30,000 and because of non-disclosure of certain risks to the insurance company, the vehicles were uninsured. As a result of this event, Omikron wishes to recognise an impairment loss of \$45,000 (inclusive of the loss of the stolen vehicles) due to the decline in the value in use of the cash generating unit, that is the taxi business. On 1 March 20X8 a rival taxi company commenced business in the same area. It is anticipated that the business revenue of Omikron will be reduced by 25% leading to a decline in the present value in use of the business which is calculated at \$150,000. The fair value less costs of disposal of the taxi licence has fallen to \$25,000 as a result of the rival taxi operator. The fair values less costs of disposal of the other assets have remained the same as at 1 January 20X8 throughout the period.

(7 marks)

Required

Describe how Omikron should treat the above impairments of assets in its financial statements. Candidates should show the treatment of the impairment loss at 1 February 20X8 and 1 March 20X8.

(Total = 20 marks)

9 Omega 1 (12/06)

39 mins

Omega is an entity that owns three properties. All three properties were purchased on 1 October 20X4. Details of the purchase price and market values of the properties are as follows:

	Property 1 \$'000	Property 2 \$'000	Property 3 \$'000
Purchase price	15,000	10,000	12,000
Market value 30 September 20X5	16,000	11,000	13,500
Market value 30 September 20X6	17,000	9,000	14,500

Properties 1 and 2 are used by Omega as factories while property 3 is let to a non-related third party at a commercial rent. Omega does not depreciate any of the properties on the basis that they are valued at market values that are generally expected to increase over time.



Required

- (a) Assess whether Omega's policy of non-depreciation of properties 1–3 is in accordance with International Financial Reporting Standards. (7 marks)
- (b) Show how the movements in the carrying amount of each property will be reflected in the financial statements of Omega for the years ended 30 September 20X5 and 20X6. You can assume that any relevant depreciation is immaterial.

Where necessary you should justify your treatment with reference to appropriate International Financial Reporting Standards. Where more than one treatment is permitted under International Financial Reporting Standards you should show the impact of both treatments. (6 marks)

- (c) On 1 October 20X5 Omega brought into use an industrial site that had been constructed at a total cost of \$50m. Omega has the legal right to use the site for a ten-year period, at the end of which the site has to be returned to the legal owner in its original condition. The directors of Omega estimate that the cost of restoring the site ten years later, on 30 September 20Y5, will be \$15m (in 20Y5 prices). The construction cost includes the right to use the site without further payment for the ten-year period. The rate to use in any discounting calculations is 8%. The present value of \$1,000 receivable in ten years when the cost of capital is 8% is \$463.

Required

Show the amounts that will appear in the statement of financial position of Omega as at 30 September 20X6 in respect of the site and the amounts that will appear in the statement of profit or loss for the year ended 30 September 20X6. You should state where in the statement of financial position and where in the statement of profit or loss and other comprehensive income the relevant amounts should be presented. Where necessary you should justify your treatment with reference to appropriate International Financial Reporting Standards. (7 marks)

(Total = 20 marks)

10 Omega 10 (6/10)

39 mins

Omega prepares financial statements under International Financial Reporting Standards (IFRS). In the two-year period ended 31 March 20X9 the following events occurred:

- (a) On 1 October 20X7 Omega began the construction of a new factory. Costs relating to the factory were as follows:

	\$'000
Purchase of land on which to build the factory	20,000
Cost of materials needed to construct the factory (Note 1)	8,000
Monthly employment costs of the construction staff (Note 1)	500
Monthly amount of other overheads directly related to the construction (Note 1)	200
Payments to external advisors relating to the construction	500
Income from temporary use of part of the site as a car park during the construction period.	(250)
Costs relating to the public opening of the factory (Note 2)	200

Note 1

In December 20X7 a fire destroyed materials costing \$500,000. The cost of these materials is included in the material figure that is given above. Construction work was suspended for two weeks because of the fire. The construction workers continued to be paid during this two-week period and other additional overheads of \$40,000 were incurred in this period. These related to keeping the construction site secure during the temporary cessation of construction.



Note 2

Construction of the factory was completed on 28 February 20X8 and the construction workers transferred to other projects from that date. The factory was not available for use until 31 March 20X8, when the factory was inspected by local government officials (as required by local legal regulations) and certified as safe for use. The factory was not actually brought into use until 31 May 20X8, following a public opening ceremony.

Note 3

The depreciable element of the factory comprises the building costs. The majority of these costs have an estimated useful life of 40 years. However, the factory roof will need to be replaced after 20 years. The estimated cost of replacing the roof at current prices is \$2.4m.

Note 4

Omega computes its depreciation charge on a monthly basis and measures property, plant and equipment using the cost model.

Note 5

No impairment of the factory had occurred by 31 March 20X9.

Required

Compute the carrying amount of the factory in the statement of financial position of Omega at 31 March 20X9. You should support your computations with appropriate explanations of the amount you have included for the cost of the factory and for its subsequent depreciation. **(12 marks)**

- (b) On 31 December 20X8 the directors of Omega decided to dispose of two properties in different locations. Both properties were actively marketed by the directors from 1 January 20X9 and sales are expected before the end of July 20X9.

Summary details of the two properties are as follows:

Property	Carrying amount at 31 March 20X8 \$'000	Depreciable amount at 31 March 20X8 \$'000	Estimated future useful life at 31 March 20X8	Estimated fair value less costs to sell at 31 December 20X8
A	25,000	15,000	30 years	28,000
B	22,000	16,000	40 years	18,000

Property A was available for sale without modifications from 1 January 20X9 onwards. On 31 March 20X9 the directors of Omega were reasonably confident that a sale could be secured for \$28m. However, after the year-end property prices in the area in which property A is located started to decline. This was due to an unexpected adverse local economic event in April 20X9. Following this event the directors of Omega estimated that property A would now be sold for \$22m less selling costs and they are very confident that this lower price can be achieved.

Property B needed repair work carried out on it before a sale could be completed. This repair work was carried out in the two-week period beginning 10 April 20X9. The costs of this repair work are reflected in the estimated fair value less costs to sell figure for property B of \$18m (see above). This estimate remains valid.

Required

Compute:

- The carrying amounts of both properties in the statement of financial position of Omega at 31 March 20X9
- The amounts charged to the statement of profit or loss and other comprehensive income in respect of both properties for the year ended 31 March 20X9

You should support your computations with appropriate explanations of the treatments you have adopted. **(8 marks)**

(Total = 20 marks)



11 Leases

39 mins

- (a) Blackcutt, a local government organisation, has outsourced its waste collection to a private sector provider called Waste and Co and pays an annual amount to Waste and Co for its services. Waste and Co purchases the vehicles and uses them exclusively for Blackcutt's waste collection. The vehicles are painted with the Blackcutt local government organisation name and colours. Blackcutt can use the vehicles and the vehicles are used for waste collection for nearly all of the asset's life. If a vehicle breaks down or no longer functions, Waste and Co must provide replacement vehicles fitted with the same waste disposal containers and equipment and painted with the local government organisations name and colours.

Required

Applying the principles of IFRS 16 *Leases*, discuss how this transaction should be accounted for in the financial statements of Blackcutt. (7 marks)

- (b) On 1 January 20X1, Heggie leased a machine under a five year lease. The useful life of the asset to Heggie was four years and there is no residual value.

The annual lease payments are \$6 million payable in arrears each year on 31 December. The present value of the future lease payments at 1 January 20X1 was \$24 million using the interest rate implicit in the lease of approximately 8% per annum. At the end of the lease term legal title remains with the lessor. Heggie incurred \$0.4 million of direct costs of setting up the lease.

The directors have not leased an asset before and are unsure how to account for it.

Required

Discuss, with suitable computations, the accounting treatment of the above transaction in Heggie's financial statements for the year ended 31 December 20X1. Work to the nearest \$0.1 million. (5 marks)

- (c) William, a public limited company, owned a building on which it raised finance. William sold the building for \$6 million, its fair value, to a finance company on 1 June 20X2 when the carrying amount was \$3.6 million. The same building was leased back from the finance company for a period of 20 years. The remaining useful life of the building is 25 years. The lease rentals for the period are \$441,000 payable annually in arrears. The interest rate implicit in the lease is 7%. The present value of the lease payments is \$5 million. The transaction constitutes a sale in accordance with IFRS 15 *Revenue from Contracts with Customers*.

William wishes to know how to account for the above transaction for the year ended 31 May 20X3.

Required

Discuss, with suitable computations, the advice that should be given to William in accounting for this transaction. (8 marks)

(Total = 20 marks)

12 Grimble Co

39 mins

You are the financial director of Grimble Co, a listed company. Your new group managing director, appointed from one of Grimble Co's foreign subsidiaries, is reviewing the principal accounting policies and is having difficulty understanding the accounting treatment and disclosure of assets leased by Grimble Co as lessor, of which there are a substantial number (both finance and operating leases).

- (a) Prepare a memorandum for your managing director explaining the basics of accounting for leased assets by lessors in the accounts of listed companies (in full compliance with the relevant accounting standards). Your memorandum should be set out in sections as follows:
- (i) Outline the factors, which can influence the decision as to whether a particular lease is a finance lease or an operating lease. (4 marks)

(ii) Illustrate your answer using the following non-cancellable lease details as an example:

- Fair value of the leased asset: \$100,000.
- Lease payments: five annual payments in advance of \$20,000 each.
- Estimated residual value at the end of the lease: \$26,750 of which \$15,000 is guaranteed by the lessee. The interest rate implicit in the lease is 10%.

Explain whether the lease should be considered as a finance lease or an operating lease under the provisions of IFRS 16. (4 marks)

(b) Grimble Co leased an item of equipment to a customer commencing on 1 January 20X5. The expected useful life of the asset is eight years.

The terms of the lease were 8 annual payments of \$4 million, commencing on 31 December 20X5. The lessee guarantees that the residual value of the assets at the end of the lease will be \$2 million (although Grimble Co expects to be able to sell it for its parts for \$3 million). The present value of the lease payments including the residual value guarantee (discounted at the interest rate implicit in the lease of 6.2%) was \$25.9 million. This was equivalent to the purchase price. The present value of \$1 payable in eight years' time with an annual discount rate of 6.2% is 61.8 cents.

Required

Discuss the accounting treatment of the above lease in the financial statements of Grimble Co for the year ended 31 December 20X5, including relevant calculations.

Work to the nearest \$0.1 million.

(7 marks)

Note. Ignore income taxes.

(c) Grimble Co leased a property to Booker Co commencing on 1 January 20X5. The lease was for five years at an annual rate of \$100,000. As an incentive, Booker Co was given a rent-free period of six months at the commencement of the lease. The useful life of the property was 30 years. Grimble Co is responsible for maintenance of the property and no extension of the lease is possible at the end of the lease term.

Required

Discuss the accounting treatment of the above lease in the financial statements of Grimble Co for the year ended 31 December 20X5, including relevant calculations.

(5 marks)

(Total = 20 marks)

13 Delta (6/15) (amended)

39 mins

Delta is an entity which prepares financial statements to 31 March each year. The financial statements for the year ended 31 March 20X5 are to be authorised for issue on 30 June 20X5. The following events are relevant to these financial statements:

- (a) On 1 April 20X4, Delta sold a property for \$48m to raise cash to expand its business. The transaction constituted a sale under IFRS 15 *Revenue from Contracts with Customers*. The carrying value of the property on 1 April 20X4 was \$50m and its fair value was \$55m. The estimated future useful life of the property on 1 April 20X4 was 40 years. On 1 April 20X4, Delta began to lease this property on a ten-year lease. The annual lease rentals for the first five years of the lease were set at \$1m. For the final five years of the lease, the rentals were set at \$1.5m. Both of these rental amounts were below the market rental for a property of this nature. The present value of the lease payments is \$9 million and the implicit interest rate in the lease is 5.9%. (11 marks)
- (b) On 1 April 20X4, Delta purchased 1 million options to acquire shares in Epsilon, a listed entity. Delta paid 25c per option, which allows Delta to purchase shares in Epsilon for a price of \$2 per share. The exercise date for the options was 31 December 20X4. On 31 December 20X4, when the market value of a share in

Epsilon was \$2.60, Delta exercised all its options to acquire shares in Epsilon. In addition to the purchase price, Delta incurred directly attributable acquisition costs of \$100,000 on the purchase of the 1 million shares in Epsilon. Delta regarded the shares it purchased in Epsilon as part of its trading portfolio. However, Delta did not dispose of any of the shares in Epsilon between 31 December 20X4 and 31 March 20X5. On 31 March 20X5, the market value of a share in Epsilon was \$2.90. (9 marks)

Required

Explain and show how the two events should be reported in the financial statements of Delta for the year ended 31 March 20X5.

Note. The mark allocation is shown against each of the two events above.

(Total = 20 marks)

14 Dougal (12/15)

39 mins

Dougal is an entity which is engaged in the construction industry and prepares financial statements to 30 September each year. The financial statements for the year ended 30 September 20X5 are shortly to be authorised for issue. The following events are relevant to these financial statements:

- (a) On 1 October 20W0, Dougal purchased a large property for \$20m and immediately began to lease the property to Edha on an operating lease. Annual rentals were \$2m. On 30 September 20X4, the fair value of the property was \$26m. Under the terms of the lease, Edha was able to cancel the lease by giving six months' notice in writing to Dougal. Edha gave this notice on 30 September 20X4 and vacated the property on 31 March 20X5. On 31 March 20X5, the fair value of the property was \$29m. On 1 April 20X5, Dougal immediately began to convert the property into ten separate flats of equal size which Dougal intended to sell in the ordinary course of its business. Dougal spent a total of \$6m on this conversion project between 31 March 20X5 and 30 September 20X5. The project was incomplete at 30 September 20X5 and the directors of Dougal estimate that they need to spend a further \$4m to complete the project, after which each flat could be sold for \$5m. Dougal uses the fair value model to measure property whenever permitted by International Financial Reporting Standards. (9 marks)
- (b) On 1 August 20X5, Dougal purchased a machine from a supplier located in a country whose local currency is the groat. The agreed purchase price was 600,000 groats, payable on 31 October 20X5. The asset was modified to suit Dougal's purposes at a cost of \$30,000 during August 20X5 and brought into use on 1 September 20X5. The directors of Dougal estimated that the useful economic life of the machine from date of first use was five years.

Relevant exchange rates were as follows:

- 1 August 20X5 – 2.5 groats to \$1
- 1 September 20X5 – 2.4 groats to \$1
- 30 September 20X5 – 2.0 groats to \$1
- 31 October 20X5 – 2.1 groats to \$1

(7 marks)

- (c) On 1 October 20X4, Dougal granted share options to 100 senior executives. The options vest on 30 September 20X7. The number of options granted per executive depend on the cumulative revenue for the three years ended 30 September 20X7. Each executive will receive options as follows:

Cumulative revenue for the three years ended 30 September 20X7	Number of options per executive
Less than \$180m	Nil
At least \$180m but less than or equal to \$270m	200
More than \$270m	300

Dougal's revenue for the year ended 30 September 20X5 was \$50m. The directors of Dougal have produced reliable budgets showing that the revenues of Dougal for the next two years are likely to be:

- Year ended 30 September 20X6 – \$65m
- Year ended 30 September 20X7 – \$75m

On 1 October 20X4, the fair value of these share options was \$3 per option. This figure had increased to \$3.60 per option by 30 September 20X5 and was expected to be \$5 per option by 30 September 20X7. All of the 100 executives who were granted the options on 1 October 20X4 were expected to remain as employees throughout the three-year period from 1 October 20X4 to 30 September 20X7. (4 marks)

Required

Explain and show how the three events would be reported in the financial statements of Dougal for the year ended 30 September 20X5.

Note. The mark allocation is shown against each of the three events above.

(Total = 20 marks)

15 Dexterity

39 mins

- (a) During the last decade it has not been unusual for the premium paid to acquire control of a business to be greater than the fair value of its tangible net assets. This increase in the relative proportions of intangible assets has made the accounting practices for them all the more important. During the same period many companies have spent a great deal of money internally developing new intangible assets such as software and brands. IAS 38 *Intangible Assets* prescribes the accounting treatment for intangible assets.

Required

In accordance with IAS 38, discuss whether intangible assets should be recognised, and, if so, how they should be initially recorded and subsequently amortised in the following circumstances:

- (i) When they are purchased separately from other assets
- (ii) When they are obtained as part of acquiring the whole of a business
- (iii) When they are developed internally

(10 marks)

Note. Your answer should consider goodwill separately from other intangibles.

- (b) Dexterity is a public listed company. It has been considering the accounting treatment of its intangible assets and has asked for your opinion on how the matters below should be treated in its financial statements for the year to 31 March 20X1.
- (i) On 1 October 20X0 Dexterity acquired Temerity, a small company that specialises in pharmaceutical drug research and development. The purchase consideration was by way of a share exchange and valued at \$35m. The fair value of Temerity's net assets was \$15m (excluding any items referred to below). Temerity owns a patent for an established successful drug that has a remaining life of eight years. A firm of specialist advisors, Leadbrand, has estimated the current value of this patent to be \$10m, however the company is awaiting the outcome of clinical trials where the drug has been tested to treat a different illness. If the trials are successful, the value of the drug is then estimated to be \$15m. Also included in the company's statement of financial position is \$2m for medical research that has been conducted on behalf of a client. (4 marks)
 - (ii) Dexterity has developed and patented a new drug which has been approved for clinical use. The costs of developing the drug were \$12m. Based on early assessments of its sales success, Leadbrand have estimated its market value at \$20m. (3 marks)
 - (iii) In December 20X0, Dexterity paid \$5m for a television advertising campaign for its products that will run for six months from 1 January 20X1 to 30 June 20X1. The directors believe that increased sales as a result of the publicity will continue for two years from the start of the advertisements. (3 marks)

Required

Explain how the directors of Dexterity should treat the above items in the financial statements for the year to 31 March 20X1. **(10 marks as indicated)**

Note. The values given by Leadbrand can be taken as being reliable measurements. You are not required to consider depreciation aspects.

(Total = 20 marks)

16 Darby

39 mins

- (a) An assistant of yours has been criticised over a piece of assessed work that he produced for his study course for giving the definition of a non-current asset as 'a physical asset of substantial cost, owned by the company, which will last longer than one year'.

Required

Provide an explanation to your assistant of the weaknesses in his definition of non-current assets when compared to the International Accounting Standards Board's (IASB) view of assets. **(4 marks)**

- (b) The same assistant has encountered the following matters during the preparation of the draft financial statements of Darby for the year ending 30 September 20X9. He has given an explanation of his treatment of them.

- (i) Darby spent \$200,000 sending its staff on training courses during the year. This has already led to an improvement in the company's efficiency and resulted in cost savings. The organiser of the course has stated that the benefits from the training should last for a minimum of four years. The assistant has therefore treated the cost of the training as an intangible asset and charged six months' amortisation based on the average date during the year on which the training courses were completed. **(3 marks)**

- (ii) During the year the company started research work with a view to the eventual development of a new processor chip. By 30 September 20X9 it had spent \$1.6m on this project. Darby has a past history of being particularly successful in bringing similar projects to a profitable conclusion. As a consequence the assistant has treated the expenditure to date on this project as an asset in the statement of financial position.

Darby was also commissioned by a customer to research and, if feasible, produce a computer system to install in motor vehicles that can automatically stop the vehicle if it is about to be involved in a collision. At 30 September 20X9, Darby had spent \$2.4m on this project, but at this date it was uncertain as to whether the project would be successful. As a consequence the assistant has treated the \$2.4m as an expense in the statement of profit or loss and other comprehensive income.

(4 marks)

- (iii) Darby signed a contract (for an initial three years) in August 20X9 with a company called Media Today to install a satellite dish and cabling system to a newly built group of residential apartments. Media Today will provide telephone and television services to the residents of the apartments via the satellite system and pay Darby \$50,000 per annum commencing in December 20X9. Work on the installation commenced on 1 September 20X9 and the expenditure to 30 September 20X9 was \$58,000. The installation is expected to be completed by 31 October 20X9. Previous experience with similar contracts indicates that Darby will make a total profit of \$40,000 over the three years on this initial contract. The assistant correctly recorded the costs to 30 September 20X9 of \$58,000 as a non-current asset, but then wrote this amount down to \$40,000 (the expected total profit) because he believed the asset to be impaired.

The contract is not a lease. Ignore discounting.

(4 marks)

- (iv) Darby's manufacturing facilities have recently received a favourable inspection by government computer scientists. As a result of this the company has been granted an exclusive five-year licence to manufacture and distribute a new kind of computer chip. Although the licence had no direct cost to Darby, its directors feel its granting is a reflection of the company's standing and have asked a firm of independent specialist advisors to value the licence. Accordingly they have placed a value of \$10m on it, which the assistant has capitalised in the statement of financial position. **(3 marks)**
- (v) In the current accounting period, Darby has spent \$3m sending its staff on specialist training courses. Whilst these courses have been expensive, they have led to a marked improvement in production quality and staff now need less supervision. This in turn has led to an increase in revenue and cost reductions. The directors of Darby believe these benefits will continue for at least three years and wish to treat the training costs as an asset. The assistant agrees with them and has recognised an asset in the financial statements. **(2 marks)**

Required

For each of the above items (i) to (v) comment on the assistant's treatment of them in the financial statements for the year ended 30 September 20X9 and advise him how they should be treated under International Financial Reporting Standards.

Note. The mark allocation is shown against each of the five items above.

(Total = 20 marks)

17 Lambda 2 (6/11)

39 mins

- (a) IAS 38 *Intangible Assets* deals with the recognition and subsequent measurement of intangible assets.

Required

Explain the following:

- (i) The meaning of the term 'intangible asset' and identify those intangible assets that are within the scope of IAS 38
- (ii) The criteria that need to be satisfied before expenditure can be recognised as an intangible asset under IAS 38
- (iii) How recognised intangible assets should be subsequently measured **(9 marks)**
- (b) Lambda is a listed entity that prepares consolidated financial statements. Lambda measures assets using the revaluation model wherever this is possible under International Financial Reporting Standards. During its financial year ended 31 March 20X9 Lambda entered into the following transactions:
 - (i) On 1 October 20X7 Lambda began a project to investigate a more efficient production process. Expenses relating to the project of \$2m were charged in the statement of profit or loss and other comprehensive income in the year ended 31 March 20X8. Further costs of \$1.5m were incurred in the three-month period to 30 June 20X8. On that date it became apparent that the project was technically feasible and commercially viable. Further expenditure of \$3m was incurred in the six-month period from 1 July 20X8 to 31 December 20X8. The new process, which began on 1 January 20X9, was expected to generate cost savings of at least \$600,000 per annum over the ten-year period commencing 1 January 20X9.
 - (ii) On 1 April 20X8 Lambda acquired a new subsidiary, Omicron. The directors of Lambda carried out a fair value exercise as required by IFRS 3 *Business Combinations* and concluded that the brand name of Omicron had a fair value of \$10m and would be likely to generate economic benefits for a ten-year period from 1 April 20X8. They further concluded that the expertise of the employees of Omicron contributed \$5m to the overall value of Omicron. The estimated average remaining service lives of the Omicron employees was eight years from 1 April 20X8.

- (iii) On 1 October 20X8 Lambda renewed its licence to extract minerals that are needed as part of its production process. The cost of renewal of the licence was \$200,000 and the licence is for a five-year period starting on 1 October 20X8. There is no active market for this type of licence. However, the directors of Lambda estimated that at 31 March 20X9 the fair value less costs to sell of the licence was \$175,000. They further estimated that over the remaining 54 months of its duration the licence would generate net cash flows for Lambda that had a present value at 31 March 20X9 of \$185,000.

Required

Assuming the Lambda group has no intangible assets other than those mentioned above, compute the carrying amount of intangible assets in the consolidated statement of financial position of Lambda as at 31 March 20X9. You should provide relevant explanations to support your figures. You are **not** required to compute the goodwill arising on acquisition of Omicron. **(11 marks)**

(Total = 20 marks)

18 Myriad and Epsilon

39 mins

- (a) You have been asked to assist the financial accountant of Myriad in preparing the company's financial statements for the year to 30 September 20X3. The financial accountant has asked for your advice in the following matter:

Myriad has recently adopted the use of International Financial Reporting Standards and a review of its existing policy of expensing all development expenditure is no longer considered appropriate under IAS 38 *Intangible Assets*. The new policy, to be first applied for the financial statements to 30 September 20X3, is to recognise development costs as an intangible asset where they comply with the requirements of IAS 38.

Amortisation of all **qualifying** development expenditure is on a straight-line basis over a four-year period (assuming a nil residual value). Recognised development expenditure **qualifies** for amortisation when the project starts commercial production of the related product. The amount of recognised development expenditure, and the amount qualifying for amortisation each year is as follows:

	Amount recognised \$'000	Amount qualifying as an asset for amortisation \$'000
In the year to 30 September 20X1	420	300
In the year to 30 September 20X2	250	360
In the year to 30 September 20X3	560	400
	<u>1,230</u>	<u>1,060</u>

No development costs were incurred by Myriad prior to 20X1.

Changes in accounting policies should be accounted for under IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

Required

- (i) Explain the circumstances when a company should change its accounting policies. **(4 marks)**
- (ii) Prepare extracts of Myriad's financial statements for the year to 30 September 20X3 including the comparatives figure to reflect the change in accounting policy. **(6 marks)**

Note. Ignore taxation.

- (b) Epsilon prepares consolidated financial statements under International Financial Reporting Standards. Your assistant has prepared the first draft of the financial statements for the year ended 31 March 20X6 but there is a transaction about which she is unsure. This is listed below:

Transaction

- (i) On 1 April 20X5 Epsilon acquired a new subsidiary, Kappa, purchasing all 100 million shares of Kappa. The terms of the sale agreement included the exchange of three shares in Epsilon for every two shares acquired in Kappa. On 1 April 20X5 the market value of a share in Epsilon was \$10 and the market value of a share in Kappa \$13.50.
- (ii) The terms of the share purchase included the payment of an additional \$1.21 per share acquired provided the profits of Kappa for the two years ending 31 March 20X7 exceeded a target figure.
- (iii) Legal and professional fees associated with the acquisition of Kappa shares were \$1,200,000, including \$200,000 relating to the cost of issuing shares.
- (iv) The individual statement of financial position of Kappa at 1 April 20X5 comprised net assets that had a fair value at that date of \$1,200m. Additionally Epsilon considered Kappa possessed certain intangible assets that were not recognised in its individual statement of financial position:
 - Customer relationships had a reliable estimate of value of \$100m. This value has been derived from the sale of customer databases in the past.
 - Employee expertise had a reliable estimate of value of \$80m.
- (v) The directors of Epsilon were unsure how long the goodwill on acquisition of Kappa would last but they thought that ten years might be a prudent estimate of its useful life. However, they considered that the goodwill had not suffered any impairment up to 31 March 20X6.
- (vi) The annual discount rate to use in any relevant calculations is 10%.

Required

Compute the goodwill on consolidation of Kappa that will appear in the consolidated statement of financial position of Epsilon at 31 March 20X6, giving an explanation of the components of your computation. You should make appropriate references to International Financial Reporting Standards.

(10 marks)

(Total = 20 marks)

19 Worldwide Nuclear Fuels

39 mins

Provisions are particular kinds of liabilities. It therefore follows that provisions should be recognised when the definition of a liability has been met. The key requirement of a liability is a present obligation and thus this requirement is critical also in the context of the recognition of a provision. IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* deals with this area.

Required

- (a)
 - (i) Explain why there was a need for detailed guidance on accounting for provisions. **(7 marks)**
 - (ii) Explain the circumstances under which a provision should be recognised in the financial statements according to IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. **(6 marks)**
- (b) Discuss whether the following provisions have been accounted for correctly under IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.

WorldWide Nuclear Fuels, a public limited company, disclosed the following information in its financial statements for the year ending 30 November 20X9.

Provisions and long-term commitments

Provision for decommissioning the group's radioactive facilities is made over their useful life and covers complete demolition of the facility within 50 years of it being taken out of service together with any associated waste disposal. The provision is based on future prices and is discounted using a current market rate of interest.

Provision for decommissioning costs

	\$m
Balance at 1 December 20X8	675
Adjustment arising from change in price levels charged to reserves	33
Charged in the year to profit or loss	125
Adjustment due to change in knowledge (charged to reserves)	27
Balance at 30 November 20X9	<u>860</u>

There are still decommissioning costs of \$1,231m (undiscounted) to be provided for in respect of the group's radioactive facilities as the company's policy is to build up the required provision over the life of the facility. (7 marks)

(Total = 20 marks)

20 Epsilon 7 (12/08) (amended)

39 mins

Epsilon is a listed entity. You are the financial controller of the entity and its consolidated financial statements for the year ended 30 September 20X8 are being prepared. Your assistant, who has prepared the first draft of the statements, is unsure about the correct treatment of a number of transactions and has asked for your advice. Details of the transactions are given below:

Transaction (a)

On 31 August 20X8 the directors decided to close a business segment which did not fit into its future strategy. The closure commenced on 5 October 20X8 and was due to be completed on 31 December 20X8. On 6 September 20X8 letters were sent to relevant employees offering voluntary redundancy or redeployment in other sectors of the business. On 13 September 20X8 negotiations commenced with relevant parties with a view to terminating existing contracts of the business segment and arranging sales of its assets. Latest estimates of the financial implications of the closure are as follows:

- (i) Redundancy costs will total \$30m, excluding the payment referred to in (ii) below.
- (ii) The pension plan (a defined benefit plan) will make a lump sum payment totalling \$8m to the employees who accept voluntary redundancy for termination of their rights under the plan. Epsilon will pay this amount into the plan on 31 January 20X9. The actuaries have advised that the accumulated pension rights that this payment will extinguish have a present value of \$7m and this sum is unlikely to alter significantly before 31 January 20X9.
- (iii) The cost of redeploying and retraining staff who do not accept redundancy will total \$6m.
- (iv) Plant having a net carrying amount of \$11m at 30 September 20X8 will be sold for \$2m.
- (v) The operating losses of the business segment for October, November and December 20X8 are estimated at \$10m.

Your assistant is unsure of the extent to which the above transactions create liabilities that should be recognised as a closure provision in the financial statements. He is also unsure as to whether or not the results of the business segment that is being closed need to be shown separately.

Required

Explain how the decision to close the business segment should be reported in the financial statements of Epsilon for the year ended 30 September 20X8. (11 marks)

Transaction (b)

On 1 June 20X8 Epsilon opened a new factory in an area designated by the Government as an economic development area. On that day the Government provided Epsilon with a grant of \$30m to assist it in the development of the factory. This grant was in three parts:

- (i) \$6m of the grant was a payment by the Government as an inducement to Epsilon to begin developing the factory. No conditions were attached to this part of the grant.
- (ii) \$15m of the grant related to the construction of the factory at a cost of \$60m. The land was leased so the whole of the \$60m is depreciable over the estimated 40 year useful life of the factory.
- (iii) The remaining \$9m was received subject to keeping at least 200 employees working at the factory for a period of at least five years. If the number drops below 200 at any time in any financial year in this five year period then 20% of the grant is repayable in that year. From 1 June 20X8 220 workers were employed at the factory and estimates are that this number is unlikely to fall below 200 over the relevant five-year period.

Required

Explain how the grant of \$30m should be reported in the financial statements of Epsilon for the year ended 30 September 20X8. Where International Financial Reporting Standards allow alternative treatments of any part of the grant you should explain both treatments. (9 marks)

(Total = 20 marks)

21 Delta 2 (6/12) (amended)

39 mins

Delta is an entity that prepares financial statements to 31 March each year. During the year ended 31 March 20X2 the following events occurred:

- (a) On 1 April 20X1, Delta purchased some land for \$10m. Delta purchased the land in order to extract minerals from it. During the six months from 1 April 20X1 to 30 September 20X1, Delta incurred costs totalling \$3.5m in preparing the land and erecting extraction equipment. This process caused some damage to the land. Delta began extracting the minerals on 1 October 20X1 and the directors estimate that there are sufficient minerals to enable the site to have a useful life of ten years from that date. Further damage to the land is caused as the minerals are extracted.

Delta is legally obliged to rectify the damage caused by the preparation and mineral extraction. The directors estimate that the costs of this rectification on 30 September 20X1 will be as follows:

- (i) \$3m to rectify the damage caused by the preparation of the land
- (ii) \$200,000 for each year of the extraction process to rectify damage caused by the extraction process itself

Following this rectification work the land could potentially be sold to a third party for no less than its original cost of \$10m.

An annual discount rate appropriate for this project is 12%. The present value of \$1 payable in ten years' time with an annual discount rate of 12% is 32.2 cents. The present value of \$1 payable in 9½ years' time with an annual discount rate of 12% is 34.1 cents. (9 marks)

- (b) On 1 April 20X1, Delta granted 20,000 share options to each of 100 senior executives. The options vest on 31 March 20X4, provided the executives remain with Delta throughout the period ending on 31 March 20X4 and providing the share price of Delta is at least \$1.60 on that date. Relevant data relating to the share options is as follows:

Date	Market value of:	
	Granted option	Delta share
1 April 20X1	\$0.84	\$1.20
31 March 20X2	\$0.90	\$1.28

On 1 April 20X1, estimates suggested that 95 of the executives would remain with Delta throughout the period. This estimate changed to 92 executives on 31 March 20X2. (5 marks)

- (c) At 31 March 20X2, Delta was engaged in a legal dispute with a customer who alleged that Delta had supplied faulty products that caused the customer actual financial loss. The directors of Delta consider that the customer has a 75% chance of succeeding in this action and that the likely outcome should the customer succeed is that the customer would be awarded damages of \$1m. The directors of Delta further believe that the fault in the products was caused by the supply of defective components by one of Delta's suppliers. Delta has initiated legal action against the supplier and considers there is a 70% chance Delta will receive damages of \$800,000 from the supplier. Ignore discounting in this part of the question. (3 marks)
- (d) On 10 April 20X2, a water leak at one of Delta's warehouses damaged a consignment of inventory. This inventory had been manufactured prior to 31 March 20X2 at a total cost of \$800,000. The net realisable value of the inventory prior to the damage was estimated at \$960,000. Because of the damage Delta was required to spend a further \$150,000 on repairing and re-packaging the inventory. The inventory was sold on 15 May 20X2 for proceeds of \$900,000. Any adjustment in respect of this event would be regarded by Delta as material. (3 marks)

Required

Explain and show how the four events would be reported in the financial statements of Delta for the year ended 31 March 20X2.

Note. The mark allocation is shown against each of the four events above.

(Total = 20 marks)

22 Kappa 4 (6/09)

39 mins

IAS 19 *Employee Benefits* is applied to all employee benefits other than those to which IFRS 2 *Share-based Payment* applies. Accounting for short-term employee benefits is relatively straightforward. However, accounting for post-employment benefits can be rather more complex. This particularly applies where post-employment benefits are provided via defined benefit plans.

Required

Explain:

- (a) The meaning of post-employment benefits and the manner in which such benefits that are provided via defined contribution plans should be measured and recognised in the financial statements of employers (3 marks)
- (b) The amounts that should be included in the financial statements of employers regarding post-employment benefits provided via defined benefit plans (ignore the effect of remeasurements at this stage) (6 marks)

Kappa provides post-employment benefits to its employees through a defined benefit plan. The following data relates to the plan:

	Year ended 31 March	
	20X9	20X8
	\$'000	\$'000
Present value of obligation at year end	36,000	33,000
Fair value of plan assets at year end	31,000	30,000
Current service cost	6,000	5,700
Benefits paid by plan	8,000	7,500
Contributions paid into plan	5,800	5,600
Yield on high quality corporate bonds at the start of the year	10%	9%

Required

- (c) Prepare extracts from Kappa's statement of financial position at 31 March 20X9 and from its statement of profit or loss and other comprehensive income for the year ended 31 March 20X9 relating to the defined benefits plan. (11 marks)

(Total = 20 marks)

23 Omicron 2 (12/11)

39 mins

- (a) IAS 19 *Employee Benefits* is a comprehensive standard that deals with the financial reporting of short and long-term employee benefits. The most complex type of employee benefit dealt with in IAS 19 is post-employment benefits. Such benefits are usually provided via a separate plan into which the employer makes contributions. The impact of such arrangements on the financial statements of contributing employers depends on the type of retirement benefit plan.

One of the particularly complex aspects of the standard is the treatment of actuarial gains and losses arising on the measurement of obligations relating to post-employment benefits. IAS 19 allows a number of alternative treatments.

Required

You are required to provide an explanation of:

- (a) (i) The difference between a defined contribution and a defined benefit plan. Your explanation should include an analysis of which party bears the risks attaching to the level of benefits. (4 marks)
- (ii) The difference, in the financial statements of contributing employers, between the method of accounting for contributions to defined contribution plans and contributions to defined benefit plans. (3 marks)
- (iii) How actuarial gains and losses are reported. (1 mark)
- (b) Omicron prepares financial statements to 30 September each year. Omicron makes contributions to a defined benefit post-employment benefit plan for its employees. Relevant data is as follows:
- (i) At 1 October 20X0 the plan obligation was \$35m and the fair value of the plan assets was \$30m.
- (ii) The actuary advised that the current service cost for the year ended 30 September 20X1 was \$4m. Omicron paid contributions of \$3.2m to the plan on 30 September 20X1. These were the only contributions paid in the year.
- (iii) The appropriate annual rate at which to discount the plan liabilities was 6% on 1 October 20X0 and 5.5% on 30 September 20X1.
- (iv) The plan paid out benefits totalling \$2m to retired members on 30 September 20X1.
- (v) At 30 September 20X1 the plan obligation was \$41.5m and the fair value of the plan assets was \$32.5m.

Required

Compute the amounts that will appear in the statement of profit loss and other comprehensive income of Omicron for the year ended 30 September 20X1 and the statement of financial position at 30 September 20X1 in respect of the post-employment benefit plan.

Note. You should indicate where in each statement the relevant amounts will be presented. (12 marks)

(Total = 20 marks)

24 Avco**39 mins**

- (a) The difference between debt and equity in an entity's statement of financial position is not easily distinguishable for preparers of financial statements. Some financial instruments may have both features, which can lead to inconsistency of reporting. The International Accounting Standards Board (IASB) has agreed that greater clarity may be required in its definitions of assets and liabilities for debt instruments. It is thought that defining the nature of liabilities would help the IASB's thinking on the difference between financial instruments classified as equity and liabilities.

Required

Discuss the key classification differences between debt and equity under International Financial Reporting Standards.

Note. Examples should be given to illustrate your answer.

(10 marks)

- (b) The directors of Avco, a public limited company, are reviewing the financial statements of two entities which are acquisition targets, Cavor and Lidan. They have asked for clarification on the treatment of the following financial instruments within the financial statements of the entities.

Cavor has two classes of shares: A and B shares. A shares are Cavor's ordinary shares and are correctly classed as equity. B shares are not mandatorily redeemable shares but contain a call option allowing Cavor to repurchase them. Dividends are payable on the B shares if, and only if, dividends have been paid on the A ordinary shares. The terms of the B shares are such that dividends are payable at a rate equal to that of the A ordinary shares. Additionally, Cavor has also issued share options which give the counterparty rights to buy a fixed number of its B shares for a fixed amount of \$10m. The contract can be settled only by the issuance of shares for cash by Cavor.

Lidan has in issue two classes of shares: A shares and B shares. A shares are correctly classified as equity. Two million B shares of nominal value of \$1 each are in issue. The B shares are redeemable in two years' time. Lidan has a choice as to the method of redemption of the B shares. It may either redeem the B shares for cash at their nominal value or it may issue one million A shares in settlement. A shares are currently valued at \$10 per share. The lowest price for Lidan's A shares since its formation has been \$5 per share.

Required

Discuss whether the above arrangements regarding the B shares of each of Cavor and Lidan should be treated as liabilities or equity in the financial statements of the respective issuing companies. **(10 marks)**

(Total = 20 marks)**25 Seltec and Kappa****39 mins**

- (a) Seltec, a public limited company, processes and sells edible oils and uses several financial instruments to spread the risk of fluctuation in the price of the edible oils. The entity operates in an environment where the transactions are normally denominated in dollars. The functional currency of Seltec is the dollar.

The entity uses forward and futures contracts to protect it against fluctuation in the price of edible oils. Where forwards are used the company often takes delivery of the edible oil and sells it shortly afterwards. The contracts are constructed with future delivery in mind but the contracts also allow net settlement in cash as an alternative. The net settlement is based on the change in the price of the oil since the start of the contract. Seltec uses the proceeds of a net settlement to purchase a different type of oil or purchase from a different supplier. Where futures are used these sometimes relate to edible oils of a different type and market than those of Seltec's own inventory of edible oil. The company intends to apply fair value hedge accounting to these contracts in order to protect itself from earnings volatility.

Required

Seltec is unsure as to the nature of derivatives and hedge accounting techniques and has asked your advice on how the above financial instrument should be dealt with in the financial statements. **(14 marks)**



- (b) Kappa is a listed entity whose year-end date is 30 September 20X7. On 1 October 20X6 Kappa issued a \$6m convertible loan note. The quoted rate of interest on the loan note was 2% per annum, payable on 30 September in arrears. The loan note was repayable at an amount of \$7m on 30 September 20X9. As an alternative to repayment the lender may choose to receive 1 million shares in Kappa (having a nominal value of \$1 each).

The required rate of return for providers of this type of loan finance at 1 October 20X6 was 10% per annum.

Required

Prepare extracts that show how the loan would be presented in the financial statements of Kappa for the year ended 30 September 20X7.

(6 marks)

(Total = 20 marks)

26 Delta (12/12) (amended)

39 mins

You are the financial controller of Delta. Your assistant is preparing the first draft of the financial statements for the year ended 30 September 20X2. He has a reasonable general accounting knowledge but is not familiar with the detailed requirements of all relevant international financial reporting standards. There are three issues on which he requires your advice and he has sent you a memorandum as shown below:

- (a) On 1 October 20X1, we lent \$2m to a supplier in order to assist them with their expansion plans. We fully expected them to be able to repay us in full with ease. The loan cost us \$100,000 to arrange, so I guess we need to charge \$100,000 as a cost in the current year? We agreed not to charge interest on this loan to help our supplier's short-term cash flow but expected the supplier to repay \$2.4m on 30 September 20X3. This will mean we can't take any profit this year but there will be a nice bonus next year when we receive repayment. I was told by the finance department that the effective annual rate of interest on this loan is 6.9%. I don't understand the relevance of this information as no interest is payable.

Just before the year end, I heard from the supplier that the poor economic climate has caused them significant problems and in order to help them we agreed to reduce the amount repayable by them on 30 September 20X3 to \$2.2m. This still means we will report a profit next year though, doesn't it?

(7 marks)

- (b) On 1 October 20X0, we bought a large machine for \$20m. This machine has an estimated useful life of eight years, but will need a substantial overhaul on 30 September 20X4 in order to enable it to be used for the final four years of its estimated life. This overhaul is likely to cost \$4m, based on prices prevailing at 1 October 20X0. If the overhaul occurs, the machine is expected to have a reasonable resale value at the end of its useful life. On 1 October 20X0, the estimated residual value of the machine was \$1m. On 30 September 20X1, this estimate was revised to \$1.1m and on 30 September 20X2, the estimate was revised to \$1.2m. For some reason we didn't charge depreciation on this asset in the year to 30 September 20X1. I think this was a mistake, so I suppose I should correct this by charging two years' depreciation in the current year?

(8 marks)

- (c) During the year ended 30 September 20X2, we provided consultancy services to a customer regarding the installation of a new production system. The system has caused the customer considerable problems, so the customer has taken legal action against us for the loss of profits that has arisen as a result of the problems with the system. Our legal department considers that there is a 25% chance the claim can be successfully defended, but a 75% chance that we will be required to pay damages of \$1.6m. We shouldn't suffer any overall loss because our legal people also tell me they are reasonably confident we are covered by insurance against these types of loss. We'll make a claim as soon as the outcome of the case is confirmed.

I assume nothing needs to be provided for here because we are covered but do I need any note disclosures?

(5 marks)

Required

Draft a reply to the questions raised by your assistant. Your reply should include any additional explanations you consider relevant. In all cases, you should compute the impact on the reported earnings for the year ended 30 September 20X2.

(Total = 20 marks)

27 Ontario (6/16)

39 mins

You are the financial controller of Ontario, a listed entity which prepares consolidated financial statements in accordance with International Financial Reporting Standards (IFRS). The managing director, who is not an accountant, has recently attended a business seminar at which financial reporting issues were discussed. Following the seminar, she reviewed the financial statements of Ontario for the year ended 31 March 20X6. Based on this review she has prepared a series of queries relating to those statements:

Query One

'One of the issues discussed at the seminar was 'impairment of financial assets'. On reviewing our financial statements I have noticed that we have two types of financial assets – Type A (those measured at amortised cost) and Type B (those measured at 'fair value through profit or loss'). It appears we carry out impairment reviews of Type A assets but not Type B assets. Please explain to me why this is the case and also please explain exactly how an impairment review of Type A assets is carried out.'

(8 marks)

Query Two

'Another issue discussed at the seminar was financial reporting by farming entities. The issue of 'biological assets' was mentioned. I don't really understand what these are or how they're recognised and measured in the financial statements. Please explain this to me.'

(5 marks)

Query Three

'During a break-out session I heard someone talking about accounting policies and accounting estimates. He said that when there's a change of these items sometimes the change is made retrospectively and sometimes it's made prospectively. Please explain the difference between an accounting policy and an accounting estimate and give me an example of each. Please also explain the difference between retrospective and prospective adjustments and how this applies to accounting policies and accounting estimates.'

(7 marks)

Required

Provide answers to the three questions raised by the managing director. Your answers should refer to relevant provisions of International Financial Reporting Standards.

Note. The mark allocation is shown against each of the three issues above.

(Total = 20 marks)

28 Kappa (12/13)

39 mins

- (a) When preparing financial statements it is important to ensure that the tax consequences of all transactions are appropriately recognised. IAS 12 *Income Taxes* prescribes the treatment of both current and deferred tax assets and liabilities.

Current tax is the amount of income tax payable or recoverable in respect of the taxable profit or tax loss for a period. Deferred tax is tax on temporary differences. A temporary difference is the difference between the carrying amount of an asset or liability and its tax base. A taxable temporary difference leads to a potential deferred tax liability and a deductible temporary difference leads to a potential deferred tax asset.



Required

Explain how the tax base of both an asset and a liability is computed and state the general requirements of IAS 12 regarding the recognition of both deferred tax liabilities and deferred tax assets. You do not need to identify any of the exceptions to these general requirements which are set out in IAS 12. (5 marks)

- (b) Kappa prepares consolidated financial statements to 30 September each year. During the year ended 30 September 20X3 Kappa entered into the following transactions:
- (i) On 1 October 20X2, Kappa purchased an equity investment for \$200,000. The investment was designated as fair value through other comprehensive income. On 30 September 20X3, the fair value of the investment was \$240,000. In the tax jurisdiction in which Kappa operates, unrealised gains and losses arising on the revaluation of investments of this nature are not taxable unless the investment is sold. Kappa has no intention of selling the investment in the foreseeable future. (5 marks)
 - (ii) On 1 August 20X3, Kappa sold products to Omega, a wholly owned subsidiary operating in the same tax jurisdiction as Kappa, for \$80,000. The goods had cost Kappa \$64,000. By 30 September 20X3, Omega had sold 40% of these goods, selling the remaining 60% in October and November 20X3. (6 marks)
 - (iii) On 31 March 20X3, Kappa received \$200,000 from a customer. This payment was in respect of services to be provided by Kappa from 1 April 20X3 to 31 January 20X4. Kappa recognised revenue of \$120,000 in respect of this transaction in the year ended 30 September 20X3 and will recognise the remainder in the year ended 30 September 20X4. Under the tax jurisdiction in which Kappa operates, the \$200,000 received on 31 March 20X3 was included in the taxable profits of Kappa for the year ended 30 September 20X3. (4 marks)

Required

Explain and show how the tax consequences (current and deferred) of the three transactions would be reported in the statement of financial position of Kappa at 30 September 20X3 and its statement of profit or loss and other comprehensive income for the year ended 30 September 20X3.

Note. The mark allocation is shown against each of the three transactions above.

You should assume that:

- The rate of income tax in the jurisdiction in which Kappa operates is 25%
- Both Kappa and Omega are profitable companies which consistently generate annual taxable profits of at least \$1,000,000

In answering this part, you do **not** need to consider the possible offset of deferred tax assets against deferred tax liabilities.

(Total = 20 marks)

29 Epsilon (6/14)

39 mins

- (a) Deferred tax is the tax on temporary differences. Temporary differences are identified on individual assets and liabilities in the statement of financial position. Temporary differences arise when the carrying amount of an asset or liability differs from its tax base.

Required

Explain:

- (i) How IAS 12 *Income Taxes* defines the tax base of assets and liabilities. (3 marks)
- (ii) How temporary differences are identified as taxable or deductible temporary differences. (2 marks)
- (iii) The general criteria prescribed by IAS 12 for the recognition of deferred tax assets and liabilities. You do **not** need to identify any specific exceptions to these general criteria. (2 marks)

- (b) Epsilon prepares consolidated financial statements to 31 March each year. During the year ended 31 March 20X4, the following events affected the tax position of the group:
- (i) Lambda, a wholly owned subsidiary of Epsilon, made a loss adjusted for tax purposes of \$3m. Lambda is unable to utilise this loss against previous tax liabilities and local tax legislation does not allow Lambda to transfer the tax loss to other group companies. Local legislation does allow Lambda to carry the loss forward and utilise it against its own future taxable profits. The directors of Epsilon do not consider that Lambda will make taxable profits in the foreseeable future. **(2 marks)**
 - (ii) Just before 31 March 20X4, Epsilon committed itself to closing a division after the year end, making a number of employees redundant. Therefore Epsilon recognised a provision for closure costs of \$2m in its statement of financial position as at 31 March 20X4. Local tax legislation allows tax deductions for closure costs only when the closure actually takes place. In the year ended 31 March 20X5, Epsilon expects to make taxable profits which are well in excess of \$2m. On 31 March 20X4, Epsilon had taxable temporary differences from other sources which were greater than \$2m. **(3 marks)**
 - (iii) During the year ended 31 March 20X4, Epsilon capitalised development costs which satisfied the criteria in paragraph 57 of IAS 38 *Intangible Assets*. The total amount capitalised was \$1.6m. The development project began to generate economic benefits for Epsilon from 1 January 20X4. The directors of Epsilon estimated that the project would generate economic benefits for five years from that date. The development expenditure was fully deductible against taxable profits for the year ended 31 March 20X4. **(3 marks)**
 - (iv) On 1 April 20X3, the total goodwill arising on consolidation in Epsilon's consolidated statement of financial position was \$4m. On 31 March 20X4, the directors reviewed the goodwill for impairment and concluded that the goodwill was impaired by \$600,000. There was no tax deduction available for any group company as a consequence of this impairment charge as at 31 March 20X4. **(2 marks)**
 - (v) On 1 April 20X3, Epsilon borrowed \$10m. The cost to Epsilon of arranging the borrowing was \$200,000 and this cost qualified for a tax deduction on 1 April 20X3. The loan was for a three-year period. No interest was payable on the loan but the amount repayable on 31 March 20X6 will be \$13,043,800. This equates to an effective annual interest rate of 10%. Under the tax jurisdiction in which Epsilon operates, a further tax deduction of \$3,043,800 will be claimable when the loan is repaid on 31 March 20X6. **(3 marks)**

Required

Explain and show how each of these events would affect the deferred tax assets/liabilities in the consolidated statement of financial position of the Epsilon group at 31 March 20X4. Where relevant, you should assume the rate of corporate income tax is 25%.

Note. The mark allocation is shown against each of the five transactions above.

(Total = 20 marks)

30 Edgworth (6/16)

39 mins

- (a) A deferred tax liability is the amount of income tax payable in respect of taxable temporary differences. A deferred tax asset is the amount of income tax recoverable in future periods in respect of deductible temporary differences. A temporary difference is the difference between the carrying amount of an asset or liability in the statement of financial position and its tax base.

Required

- (i) Define the tax base of an asset as outlined in IAS 12 *Income Taxes*. Use your definition to compute the tax base of the following assets:
 - (1) A machine was purchased during the current accounting period for \$250,000. Depreciation of \$50,000 was charged in arriving at the accounting profit for the current period. A deduction of \$100,000 was given against taxable profits by the local tax authorities against the taxable profits of the current period. The remaining cost will be deductible in future periods, either as depreciation or as a deduction on disposal.
 - (2) A current asset of \$60,000 relates to interest receivable. The related interest revenue will be taxed on a cash basis when it is received. **(4 marks)**
- (ii) Define the tax base of a liability as outlined in IAS 12. Use your definition to compute the tax base of the following liabilities:
 - (1) \$120,000 is included in trade payables. This amount relates to purchases which qualified for a tax deduction when the purchase was made.
 - (2) \$40,000 is included in accrued liabilities. A tax deduction relating to this liability will be given when the liability is settled. **(4 marks)**
- (b) Edgworth prepares financial statements to 31 March each year. The rate of income tax applicable to Edgworth is 20%. The following information relates to transactions, assets and liabilities of Edgworth during the year ended 31 March 20X6:
 - (i) Edgworth has an investment property which it carries under the fair value model. The property originally cost \$30 million. The property had an estimated fair value of \$35 million on 31 March 20X5 and \$38 million on 31 March 20X6. In the tax jurisdiction in which Edgworth operates, gains on the fair value of investment properties are not subject to income tax until the properties are disposed of.
 - (ii) Edgworth has a 40% shareholding in Lowercroft. Edgworth purchased this shareholding for \$45 million. The shareholding gives Edgworth significant influence over Lowercroft but not control and therefore Edgworth accounts for its interest in Lowercroft using the equity method. The equity method carrying value of Edgworth's investment in Lowercroft was \$70 million on 31 March 20X5 and \$75 million on 31 March 20X6. In the tax jurisdiction in which Edgworth operates, profits recognised under the equity method are taxed if and when they are distributed as a dividend or the relevant investment is disposed of.
 - (iii) Edgworth measures its head office property using the revaluation model. The property is revalued every year on 31 March. On 31 March 20X5, the carrying value of the property (after revaluation) was \$40 million and its tax base was \$22 million. During the year ended 31 March 20X6, Edgworth charged depreciation in its statement of profit or loss of \$2 million and claimed a tax deduction for tax depreciation of \$1.25 million. On 31 March 20X6, the property was revalued to \$45 million. In the tax jurisdiction in which Edgworth operates, revaluation of property, plant and equipment does not affect taxable income at the time of revaluation.

Required

Assuming that there are no other temporary differences other than those indicated above, compute:

- The deferred tax liability of Edgworth at 31 March 20X6
- The charge or credit to both profit or loss and other comprehensive income relating to deferred tax for the year ended 31 March 20X6

You should include brief explanations to support your computations.

(12 marks)

(Total = 20 marks)

31 Delta (6/13) (amended)

39 mins

Delta is an entity which prepares financial statements to 31 March each year. The functional currency of Delta is the \$. During the year ended 31 March 20X3 the following events occurred:

- (a) On 1 April 20X2, Delta raised loan finance from European investors. The investors subscribed for 50 million €1 loan notes at par. Delta incurred incremental issue costs of €1m. Interest of €4m is payable annually on 31 March, starting on 31 March 20X3. The loan is repayable in € on 31 March 20Y2 at a premium and the effective annual interest rate implicit in the loan is 10%. The appropriate measurement basis for this loan is amortised cost. Relevant exchange rates are as follows:
- 1 April 20X2 – €1 = \$1.40
 - 31 March 20X3 – €1 = \$1.45
 - Average for year ended 31 March 20X3 – €1 = \$1.42
- (7 marks)
- (b) On 1 April 20X2, Delta began joint construction of a pipeline with another investor. Delta and the other investor have signed a contract that provides for joint operation and ownership of the pipeline. All of the ongoing expenditure, comprising maintenance plus borrowing costs, was to be shared equally. The pipeline was completed on 1 October 20X2. It was first used on 1 January 20X3, at which date its estimated useful life was 20 years. The total cash cost of constructing the pipeline was \$40m. This cost was partly financed by a loan of \$10m taken out on 1 April 20X2. The loan carries interest at an annual rate of 10% with interest payable in arrears on 31 March each year. Between 1 January 20X3 and 31 March 20X3, it was necessary to spend \$400,000 on maintenance costs.
- (7 marks)
- (c) On 1 April 20X2, the directors of Delta formed a new company, Epsilon. The directors of Delta own all the voting shares in Epsilon. In exercising their votes, the directors of Delta have agreed to act in Delta's best interests. Epsilon leased an asset from a financial institution and correctly accounted for this lease in its financial statements. Epsilon immediately leased the asset to Delta on a one year lease. The rentals payable by Delta to Epsilon were set at the same amount as the rentals payable by Epsilon to the financial institution. The terms of the lease from Epsilon to Delta gave Delta the option to extend the lease under exactly the same terms. This extension option will continue to be available on an annual basis until the lease between Epsilon and the financial institution expires. The asset is a vital one in Delta's production process. Epsilon does not undertake any other transactions.
- (6 marks)

Required

Explain and show (where possible by quantifying amounts) how the three events would be reported in the financial statements of Delta for the year ended 31 March 20X3.

Note. The mark allocation is shown against each of the three events above.

(Total = 20 marks)

32 Omega (6/14)

39 mins

You are the financial controller of Omega, a listed company which prepares consolidated financial statements in accordance with International Financial Reporting Standards (IFRS). The year end of Omega is 31 March and its functional currency is the \$. Your managing director, who is not an accountant, has recently prepared a list of questions for you concerning current issues relevant to Omega:

- (a) One of my fellow directors has informed me that on 1 January 20X4 his spouse acquired a controlling interest in one of our major suppliers, Sigma. He seemed to think that this would have implications for our financial statements. I cannot understand why. Our purchases from Sigma were \$1.5m for each month of our year ended 31 March 20X4 and I acknowledge this is a significant amount for us. However, I can't see how the share purchase on 1 January 20X4 affects our financial statements – all the purchases from Sigma were made at normal market rates, so what's the issue? Please explain this to me and identify any impact on our financial statements.
- (7 marks)

- (b) You will be aware that we intend to open a new retail store in a new location in the next few weeks. As you know, we have spent a substantial sum on a series of television advertisements to promote this new store. We paid for advertisements costing \$800,000 before 31 March 20X4. \$700,000 of this sum relates to advertisements shown before 31 March 20X4 and \$100,000 to advertisements shown in April 20X4. Since 31 March 20X4, we have paid for further advertisements costing \$400,000. I was chatting to a colleague over lunch and she told me she thought all these costs should be written off as expenses in the year to 31 March 20X4. I don't want a charge of \$1.2m against my 20X4 profits! Surely these costs can be carried forward as intangible assets? After all, our market research indicates that this new store is likely to be highly successful. Please explain and justify the treatment of these costs of \$1.2m in the financial statements for the year ended 31 March 20X4. (6 marks)
- (c) As you know, on 1 January 20X4 we purchased a machine for 2 million kroner. At that date the exchange rate was \$1 = 10 kroner. We don't have to pay for this purchase until 30 June 20X4. The kroner strengthened against the \$ in the three months following purchase and by 31 March 20X4 the exchange rate was \$1 = 8 kroner. I thought these exchange fluctuations wouldn't affect our financial statements because we have an asset and a liability denominated in kroner which was initially the same amount. We're depreciating this machine over four years so the future year-end amounts won't be the same, of course. Something I heard at a seminar, but didn't really grasp, made me think I could be mistaken. Please explain the impact of this transaction on our financial statements for the year ended 31 March 20X4. (7 marks)

Required

Provide answers to the issues raised by the managing director.

Note. The mark allocation is shown against each of the three issues above.

(Total = 20 marks)

33 Agriculture

39 mins

- (a) Agriculture is one of the world's largest industries; in some countries it is the mainstay of the gross domestic product. Yet until February 2001 when the IASB published IAS 41 *Agriculture*, no major developed accounting standard setting body had issued a comprehensive pronouncements on this topic. IAS 41 introduces what some would say are radical changes in the way agricultural enterprises should account for biological assets.

Required

Define biological assets and explain how IAS 41 requires them to be treated in the financial statements.

(5 marks)

- (b) Rotunda's main activity is agriculture. Its assets consist of farmland on which sheep (for wool) and lambs (for food) are kept and bred. Rotunda is also involved in forestry. Details relating to its assets and their fair values less point of sales costs at 1 June 20X2 and 31 May 20X3 are as follows:

<i>Fair value</i>	<i>1 June 20X2</i>	<i>31 May 20X3</i>
	\$	\$
New born lamb	25	28
Sheep (wool) aged under 5	100	105
Sheep (wool) aged over 5	80	82
Sheep for lambing aged under 6	120	110
 <i>Biological and other assets</i>	 <i>1 June 20X2</i>	 <i>31 May 20X3</i>
Animals		
Sheep (wool) aged under 5	2,000	1,800
Sheep (wool) aged over 5	1,000	1,200
Sheep for lambing aged under 6	1,500	1,500
New born lamb	none	1,250

There were 1,250 lambs born in the month of May 20X3. These can be deemed to be born on 31 May 20X3. No mature sheep were born or sold during the year.

Forestry

<i>Fair value</i>	<i>1 June 20X2</i>	<i>31 May 20X3</i>
40,000 hectares of land cost of \$500,000 in 1970)	725,000	750,000
Forest of 200,000 maple trees (planted in May 1998)	450,000	480,000

Rotunda has a policy of valuing its land on current values.

Rotunda also has a stock of cut maple trees at 31 May 20X3. These were felled in May 20X2 and recorded at their fair value of \$250,000 at that time. At 31 May 20X3 they have a fair value of \$270,000.

Government grant

In March 20X3 Rotunda passed a government inspection and became eligible to receive a government subsidy of \$120,000 aimed at companies using organic methods of farming. The grant is expected to be paid in September 20X3.

Required

Prepare statement of profit or loss and other comprehensive income and statement of financial position extracts for the year to 31 May 20X3 in respect of the above items. **(15 marks)**

(Total = 20 marks)

34 Omega 6 (12/09) (amended)

29 mins

Omega prepares financial statements to 30 September each year. The financial statements for the year ended 30 September 20X9 have not yet been authorised for issue.

- (a) Dobuicha is a newly acquired, wholly owned subsidiary of Omega which operates in Russia. Its principal activity is the exploration of the natural environment behind the Urals in Siberia, in search of mineral fuels to mine. Dobuicha has historically prepared financial statements in accordance with local Russian Accounting Standards, but as a result of its acquisition by Omega will need to prepare IFRS financial statements for the first time.

Dobuicha has incurred the following expenditures in relation to work undertaken prospecting for coal during the year ended 20X9.

During the early part of 20X8, Dobuicha acquired an area of land covering 50 km², with a view to exploring it in order to evaluate the mineral resources it contained. Dobuicha acquired the legal right to prospect for mineral resources on this land on 1 January 20X9, at a cost of \$50,000.

Dobuicha incurred surveying costs evenly through the year to 30 September 20X9 of \$150,000. Sampling costs of \$15,000 were incurred in the period 1 June 20X9 and 30 September 20X9. Drilling costs of \$25,000 were incurred between 1 October 20X8 and 31 December 20X8, and \$145,000 between 1 January 20X9 and 30 September 20X9. Other costs incurred during this latter period totalled \$25,000. Dobuicha allocated \$25,000 of general administrative overheads to the exploration of this land for the year to 30 September 20X9.

Dobuicha's policy is to capitalise as much expenditure as possible in accordance with financial reporting standards. It does not intend to charge any depreciation in respect of any asset recognised.

Required

Compute the amounts that will be included in the statement of financial position and the statement of profit or loss and other comprehensive income of Dobuicha in respect of the issue above. Your figures should be supported by appropriate explanations. **(5 marks)**

QUESTIONS

- (b) On 1 July 20X9 the directors decided to terminate production at one of the company's divisions. This decision was publicly announced on 31 July 20X9. The activities of the division were gradually reduced from 1 October 20X9 and closure is expected to be complete by 31 March 20Y0. At 31 July 20X9 the directors prepared the following estimates of the financial implications of the closure:
- (i) Redundancy costs were initially estimated at \$2m. Further expenditure of \$800,000 will be necessary to retrain employees who will be affected by the closure but remained with Omega in different divisions. This retraining will begin in early January 20Y0. Latest estimates are that redundancy costs will be \$1.9m, with retraining costs of \$850,000.
 - (ii) Plant and equipment having an expected carrying amount at 30 September 20X9 of \$8m will have a recoverable amount \$1.5m. These estimates remain valid.
 - (iii) The division is under contract to supply a customer for the next three years at a pre-determined price. It will be necessary to pay compensation of \$600,000 to this customer. The compensation actually paid, on 30 November 20X9, was \$550,000.
 - (iv) The division will make operating losses of \$300,000 per month in the last three months of 20X9 and \$200,000 per month in the first three months of 20Y0. This estimate proved accurate for October and November 20X9.

Required

Compute the amounts that will be included in the statement of profit or loss and other comprehensive income for the year ended 30 September 20X9 in respect of the decision to close the division. Your figures should be supported by appropriate explanations. Where financial information provided above does **not** result in a charge to profit or loss, you should explain why this is so. (10 marks)

(Total = 15 marks)

35 Omega (6/15)

39 mins

You are the financial controller of Omega, a listed company which prepares consolidated financial statements in accordance with International Financial Reporting Standards (IFRS). Your managing director, who is not an accountant, has recently attended a seminar and has the following questions for you concerning issues raised at the seminar:

- (a) One of the delegates at the seminar was a director of an entity which operates a number of different farms. She informed me that there was a financial reporting standard which applied to farming entities. I think she said it was IAS 41. I'd like to know why a special standard is needed for farming entities. Given that we have IAS 41, does this mean that other IFRSs do not apply to farming entities? Please explain the main recognition and measurement requirements of IAS 41 – I'm not interested in details about disclosures. I am interested, though, in any areas where the provisions of IAS 41 differ from general IFRSs. I believe I heard that farming entities treat grants from the government in a different way than other entities do. I'm particularly interested to hear about this – assuming I'm correct. (12 marks)
- (b) Another delegate, a director of a relatively small listed entity, stated that his entity did not need to comply with the detailed requirements of IFRS because of the relatively small size of the entity. Is it true that there are different accounting rules which are available for smaller entities? Can his entity take advantage of them? Please give me an outline explanation – I don't need the details of any different rules. (8 marks)

Required

Provide answers to the questions raised by the managing director.

Note. The mark allocation is shown against each of the two questions above.

(Total = 20 marks)

36 Okawa (12/15)

39 mins

You are the financial controller of Okawa, a listed company which prepares consolidated financial statements in accordance with International Financial Reporting Standards (IFRS). Your managing director, who is not an accountant, has recently attended a seminar and has raised two questions for you concerning issues discussed at the seminar:

- (a) One of the delegates at the seminar was a director of an entity which is involved in the exploration for, and evaluation of, mineral resources. This delegate told me that under IFRS rules it is possible for individual entities to develop their own policies for when to recognise the costs of exploration for and evaluation of mineral resources as assets. This seems very strange to me. Surely IFRS requires consistent treatment for all tangible and intangible assets so that financial statements are comparable. Please explain the position to me and outline the relevant requirements of IFRS regarding accounting for exploration and evaluation expenditures. (10 marks)
- (b) Another delegate was discussing the fact that the entity of which she is a director is relocating its head office staff to a more suitable site and intends to sell its existing head office building. Apparently the existing building was advertised for sale on 1 July 20X5 and the entity anticipates selling it by 31 December 20X5. The year end of the entity is 30 September 20X5. The delegate stated that in certain circumstances buildings which are intended to be sold are treated differently from other buildings in the financial statements. Please outline under what circumstances buildings which are being sold are treated differently and also what that different treatment is. (10 marks)

Required

Provide answers to the questions raised by the managing director.

Note. The mark allocation is shown against each of the two questions above.

(Total = 20 marks)

37 Lambda (12/09)

39 mins

In recent years it has become increasingly common for entities to enter into transactions with third parties that are settled by means of a share based payment. IFRS 2 *Share-based Payment* was issued in order to provide a basis of accounting for such transactions. Share based payments can be equity settled or cash settled.

Required

- (a) Explain the accounting treatment of both equity and cash settled share based payment transactions with employees. (8 marks)

Lambda prepares financial statements to 30 September each year. Lambda has a number of highly skilled employees that it wishes to retain and has put two schemes in place to discourage employees from leaving:

Scheme A

On 1 October 20X7 Lambda granted share options to 200 employees. Each employee was entitled to 500 options to purchase equity shares at \$10 per share. The options vest on 30 September 20Y0 if the employees continue to work for Lambda throughout the three-year period. Relevant data is as follows:

Date	Share price \$	Fair value of option \$	Expected number of employees for whom 500 options will vest
1 October 20X7	10	2.40	190
30 September 20X8	11	2.60	185
30 September 20X9	12	2.80	188

Scheme B

On 1 October 20X6 Lambda granted two share appreciation rights to 250 employees. Each right gave the holder a cash payment of \$100 for every 50 cent increase in the share price from the 1 October 20X6 value to the date the rights vest. The rights vest on 30 September 20X9 for those employees who continue to work for Lambda throughout the three-year period. Payment is due on 31 January 20Y0. Relevant data is as follows:

<i>Date</i>	<i>Share price</i>	<i>Fair value of option</i>	<i>Expected number of employees for whom two rights will vest</i>
	\$	\$	
1 October 20X6	9	500	240
30 September 20X7	10	520	235
30 September 20X8	11	540	240
30 September 20X9	12	600	238

(the actual number in whom 2 rights vested)

Required

- (b) (i) For both schemes, compute the charge to the statement or profit or loss for the year ended 30 September 20X9. (8 marks)
- (ii) For both schemes, compute the amount that will appear in the statement of financial position of Lambda at 30 September 20X9 and state where in the statement the relevant amount will appear. (4 marks)
- (Total = 20 marks)

38 Omega 14 (6/11) (amended)

39 mins

You are given details of three transactions affecting the financial statements of Omega:

Transaction One

On 1 April 20X6 Omega granted share options to 20 senior executives. The options are due to vest on 31 March 20X9 provided the senior executives remain with the company for that period. The number of options vesting to each director depends on the cumulative profits over the three-year period from 1 April 20X6 to 31 March 20X9:

- 10,000 options per director if the cumulative profits are between \$5m and \$10m
- 15,000 options per director if the cumulative profits are more than \$10m

On 1 April 20X6 and 31 March 20X7 the best estimate of the cumulative profits for the three-year period ending on 31 March 20X9 was \$8m. However, following very successful results in the year ended 31 March 20X8, the latest estimate of the cumulative profits in the relevant three-year period is \$14m.

On 1 April 20X6 it was estimated that all 20 senior executives would remain with Omega for the three-year period, but on 31 December 20X6 one senior executive left unexpectedly. None of the other executives have since left and none are expected to leave before 31 March 20X9.

A further condition for vesting of the options is that the share price of Omega should be at least \$12 on 31 March 20X9. The share price of Omega over the last two years has changed as follows:

- \$10 on 1 April 20X6
- \$11.75 on 31 March 20X7
- \$11.25 on 31 March 20X8

On 1 April 20X6 the fair value of the share options granted by Omega was \$4.80 per option. This had increased to \$5.50 by 31 March 20X7 and \$6.50 by 31 March 20X8.

Required

- (a) Produce extracts, with supporting explanations, from the statements of financial position at 31 March 20X7 and 20X8 and from the statements of profit or loss and comprehensive income for the years ended 31 March 20X7 and 20X8 that show how transaction one will be reflected in the financial statements of Omega.

Note. Ignore deferred tax.

(8 marks)

Transaction Two

On 1 April 20X6 Omega purchased ten new machines for \$12m each. Each machine had an overall estimated useful life of ten years. The estimated residual value of each machine was zero. Each machine will require a substantial overhaul after five years in order to maintain its operating capacity and the cost of such an overhaul at 1 April 20X6 prices was \$3m per machine. In the year ended 31 March 20X7 Omega charged total depreciation of \$12m on the machines but the directors have subsequently realised that this may have been an error that could have a material impact on the financial statements.

Required

- (b) Produce extracts, with supporting explanations, from the statements of profit or loss and comprehensive income for the years ended 31 March 20X7 and 20X8 and from the statement of changes in equity for the year ended 31 March 20X8 that show how transaction two will be reflected in the financial statements of Omega.

Note. Ignore deferred tax.

(5 marks)

Transaction Three

On 1 June 20X7 Omega signed a contract to construct a machine for one of its customers and to subsequently provide servicing facilities relating to the machine. Omega commenced construction on 1 July 20X7 and the construction took two months to complete. Omega incurred the following costs of construction:

- Materials \$1m.
- Other direct costs \$2m.
- Allocated fixed production overheads \$1m. This allocation was made using Omega's normal overhead allocation model.

On 1 October 20X7 the machine was delivered to the customer. The customer paid the full contract price of \$7.5m on 30 November 20X7. The servicing and warranty facilities are for a three-year period from 1 October 20X7. This is not considered to be an onerous contract at 31 March 20X8. In the six-month period from 1 October 20X7 to 31 March 20X8 Omega incurred costs of \$200,000 relating to the servicing and this rate of expenditure is estimated to continue over the remainder of the three-year period. Omega would normally expect to earn a profit margin of 20% on the provision of servicing facilities of this nature.

The normal stand-alone selling price of the machine is \$7m. Both the machine and the servicing facilities are capable of being sold independently of each other.

Required

- (c) Produce extracts, with supporting explanations, from the statement of financial position at 31 March 20X8 and from the statement of profit or loss and other comprehensive income for the year ended 31 March 20X8 that show how transaction three will be reflected in the financial statements of Omega.

Note. Ignore deferred tax.

(7 marks)

(Total = 20 marks)

39 Delta (6/14) (amended)

39 mins

Delta is an entity which prepares financial statements to 31 March each year. During the year ended 31 March 20X4 the following events affected Delta:

- (a) On 1 April 20X2, Delta had granted share appreciation rights to 200 senior executives. Each executive will receive 2,000 rights on 31 March 20X5 provided he or she continues to be employed by Delta at that date.

On 1 April 20X2, the directors estimated that all the executives would remain employed by Delta for the three-year period ending on 31 March 20X5. However, ten executives left in the year ended 31 March 20X3 and at 31 March 20X3 the directors believed that a further ten executives would leave in the following two years. Five executives actually left in the year ended 31 March 20X4 and the directors now believe that seven more directors will leave in the year ended 31 March 20X5. Since 1 April 20X2, the fair value of the share appreciation rights has fluctuated as follows:

Date	Fair value of one right	
	\$	
1 April 20X2	1.60	
31 March 20X3	1.80	
31 March 20X4	1.74	(8 marks)

- (b) On 1 April 20X3, Delta completed the manufacture of some inventory at a total cost of \$800,000. In order to be suitable for sale in the ordinary course of business, the completed inventory needed to be stored in controlled conditions for a two-year period. The inventory is expected to sell for \$1,200,000 after the two-year storage period. On 1 April 20X3, Delta sold the inventory to Epsilon, a bank. The agreed sales proceeds were \$810,000 but Epsilon charged Delta an administration fee of \$10,000, so the net amount received by Delta was \$800,000. Delta retained physical custody of the inventory and continued to ensure that it was stored in the appropriate conditions. Delta indemnified Epsilon against any losses caused by theft or inappropriate storage of the inventory. Delta has the option to repurchase the inventory on 31 March 20X5 for \$933,120. On 1 April 20X3, Epsilon would have required an annual return of 8% on loans made to customers such as Delta. (7 marks)
- (c) On 1 April 20X3, Delta leased a machine with a useful life of ten years from Kappa. The terms of the lease are for Delta to pay Kappa a non-refundable deposit of \$575 followed by seven annual instalments of \$2,000 payable in arrears. The interest rate implicit in the lease is 11%. The cumulative present value of \$1 payable at the end of years 1–7 using a discount rate of 11% is \$4.712. (5 marks)

Required

Explain and illustrate (where possible by quantifying amounts) how the three events would be reported in the financial statements of Delta for the year ended 31 March 20X4.

Note. The mark allocation is shown against each of the three events above. Work to the nearest \$1.

(Total = 20 marks)

40 Kappa (6/15)

39 mins

- (a) IFRS 2 *Share-based Payment* defines a share-based payment transaction as one in which an entity receives goods or services from a third party (including an employee) in a share-based payment arrangement. A share-based payment arrangement is an agreement between an entity and a third party which entitles the third party to receive either:
- Equity instruments of the entity (equity-settled share-based payments); or
 - Cash or other assets based on the price of equity instruments of the entity (cash-settled share-based payments).

Share-based payment arrangements are often subject to vesting conditions which must be satisfied over a vesting period.

Required

For both cash-settled **and** equity-settled share-based payment arrangements, explain:

- (i) The basis on which the arrangements should be measured
 - (ii) The criteria which are used to allocate the total value of the arrangement to individual accounting periods
 - (iii) The accounting entries (debit and credit) required during the vesting period (6 marks)
- (b) Kappa prepares financial statements to 31 March each year. The following share-based payment arrangements were in force during the year ended 31 March 20X5:

- (i) On 1 April 20X3, Kappa granted options to 500 employees to subscribe for 400 shares each in Kappa on 31 March 20X7, providing the employees still worked for Kappa at that time. On 1 April 20X3, the fair value of each option was \$1.50.

In the year ended 31 March 20X4, ten of these employees left Kappa and at 31 March 20X4, Kappa expected that 20 more would leave in the three-year period from 1 April 20X4 to 31 March 20X7. Kappa's results for the year ended 31 March 20X4 were below expectations and at 31 March 20X4 the fair value of each option had fallen to 25 cents. Therefore, on 1 April 20X4 Kappa amended the exercise price of the original options. This amendment caused the fair value of these options to rise from 25 cents to \$1.45.

During the year ended 31 March 20X5, five of the employees left and at 31 March 20X5, Kappa expected that ten more would leave in the two-year period from 1 April 20X5 to 31 March 20X7. The results of Kappa for the year ended 31 March 20X5 were much improved and at 31 March 20X5, the fair value of a re-priced option was \$1.60. (9 marks)

- (ii) On 1 April 20X3, Kappa granted share appreciation rights to 50 senior employees. The number of rights to which each employee becomes entitled depends on the cumulative profit of Kappa for the three years ended 31 March 20X6:

- 1,000 rights per employee are awarded if the cumulative profit for the three-year period is below \$500,000.
- 1,500 rights per employee are awarded if the cumulative profit for the three-year period is between \$500,000 and \$1m.
- 2,000 rights per employee are awarded if the cumulative profit for the three-year period exceeds \$1m.

On 1 April 20X3, Kappa expected that the cumulative profits for the three-year period would be \$800,000. After the disappointing financial results for the year ended 31 March 20X4, this estimate was revised at that time to \$450,000. However, given the improvement in results for the year ended 31 March 20X5, the estimate was revised again at 31 March 20X5 to \$1,100,000.

On 1 April 20X3, the fair value of one share appreciation right was \$1.10. This estimate was revised to \$0.90 at 31 March 20X4 and to \$1.20 at 31 March 20X5. All the senior employees are expected to remain employed by Kappa for the relevant three-year period. The rights are exercisable on 30 June 20X6. (5 marks)

Required

Show how and where transactions (i) and (ii) would be reported in the financial statements of Kappa for the year ended 31 March 20X5.

Note. The mark allocation is shown against both of the two transactions above.

Ignore deferred tax.

(Total = 20 marks)

41 Roma (6/16)

39 mins

Roma is an entity which prepares financial statements to 31 March each year. Each year the financial statements are authorised for issue on 20 May. The following events are relevant to the year ended 31 March 20X6:

Event (a)

On 1 April 20X4, Roma granted 2,000 employees 1,000 share options each. The options are due to vest on 31 March 20X7 provided the relevant employees remain in employment over the three-year period ending on 31 March 20X7.

On 1 April 20X4, the directors of Roma estimated that 1,800 employees would qualify for the options on 31 March 20X7. This estimate was amended to 1,850 employees on 31 March 20X5, and further amended to 1,840 employees on 31 March 20X6.

On 1 April 20X4, the fair value of an option was \$1.20. The fair value increased to \$1.30 by 31 March 20X5 but, due to challenging trading conditions, the fair value declined after 31 March 20X5. On 30 September 20X5, when the fair value of an option was 90 cents, the directors repriced the options and this caused the fair value to increase to \$1.05. Trading conditions improved in the second half of the year and by 31 March 20X6 the fair value of an option was \$1.25. Any additional costs that have occurred as a result of the repricing of the options on 30 September 20X5 should be spread over the remaining vesting period from 30 September 20X5 to 31 March 20X7. **(9 marks)**

Event (b)

On 1 August 20X5, Roma supplied some products it had manufactured to customer C. The products were faulty and on 1 October 20X5 C commenced legal action against Roma claiming damages in respect of losses due to the supply of the faulty products. Upon investigating the matter, Roma discovered that the products were faulty due to defective raw materials supplied to Roma by supplier S. Therefore on 1 December 20X5, Roma commenced legal action against S claiming damages in respect of the supply of defective materials. Since that date Roma has consistently estimated that it is probable that both of the legal actions, the action of C against Roma and the action of Roma against S, will succeed.

On 1 October 20X5, Roma estimated that the damages Roma would have to pay to C would be \$5 million. This estimate was updated to \$5.2 million as at 31 March 20X6 and \$5.25 million as at 15 May 20X6. This case was eventually settled on 1 June 20X6, when Roma was required to pay damages of \$5.3 million to C.

On 1 December 20X5, Roma estimated that they would receive damages of \$3.5 million from S. This estimate was updated to \$3.6 million as at 31 March 20X6 and \$3.7 million as at 15 May 20X6. This case was eventually settled on 1 June 20X6, when S was required to pay damages of \$3.75 million to Roma. **(6 marks)**

Event (c)

On 1 June 20X5, the spouse of one of the directors of Roma purchased a controlling interest in entity X, a long-standing customer of Roma. Sales of products from Roma to entity X in the two-month period from 1 April 20X5 to 31 May 20X5 totalled \$800,000. Following the share purchase by the spouse of one of the directors of Roma on 1 June 20X5, Roma began to supply the products at a discount of 20% to their normal selling price and allow entity X three months' credit (previously entity X was only allowed one month's credit, Roma's normal credit policy). Sales of products from Roma to entity X in the ten-month period from 1 June 20X5 to 31 March 20X6 totalled \$6 million. On 31 March 20X6, the trade receivables of Roma included \$1.8 million in respect of amounts owing by entity X. **(5 marks)**

Required

Explain and show (where possible by quantifying amounts) how the three events would be reported in the financial statements of Roma for the year ended 31 March 20X6.

Note. The mark allocation is shown against each of the three events above. You should assume that all amounts described here are material. When discussing event (a), you are not required to consider disclosure requirements.

(Total = 20 marks)

42 Epsilon 11 (6/12)**39 mins**

- (a) IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* deals with the measurement and reporting of assets or groups of assets that are intended to be sold or otherwise disposed of.

Required

- (i) State the criteria that need to be satisfied before an asset or disposal group is classified as held for sale under IFRS 5.
 - (ii) Explain how assets or disposal groups that are classified as held for sale are measured and presented in the statement of financial position. You need to describe only the minimum presentation requirements.
 - (iii) State the criteria that need to be satisfied before an operation is classified as discontinued under IFRS 5.
 - (iv) Identify the minimum amounts that need to be presented on the face of the statement of profit or loss and other comprehensive income in respect of discontinued operations. **(10 marks)**
- (b) Epsilon prepares financial statements to 31 March each year.

On 1 October 20X1, Epsilon decided to dispose of a business component. This business component is a disposal group that satisfied the criteria for classification as held for sale at 1 October 20X1. The carrying amounts of the relevant assets and liabilities of the component in the financial statements of Epsilon on 1 October 20X1, measured individually in accordance with applicable International Financial Reporting Standards were as follows:

	\$'000
Goodwill	10,000
Property, plant and equipment – estimated future useful life four years	25,000
Net current assets	5,000
	40,000

On 1 October 20X1, the directors of Epsilon estimated that the fair value less costs to sell of this disposal group was \$28m. The group was disposed of on 30 April 20X2 for \$31m. This was in line with a revised estimate made on 31 March 20X2.

The profit after tax of the business component for the year ended 31 March 20X2 was \$3m.

Required

- (i) Compute the carrying amount of the goodwill and property, plant and equipment of the business component on 1 October 20X1 immediately after classification as held for sale.
- (ii) Compute the carrying amount of the goodwill and property, plant and equipment of the business component on 31 March 20X2.
- (iii) Show the minimum amounts that must be presented on the face of the statement of profit or loss and other comprehensive income of Epsilon for the year ended 31 March 20X2 concerning the business component.

Note. In this part, your answer should be supported by appropriate explanations. Marks will be awarded for these explanations. **(10 marks)**

(Total = 20 marks)

43 Belloso Co

39 mins

You are the Financial Director of Belloso Co and are finalising the accounts for the year ended 31 December 20X1. The draft profit for the year is \$20,000.

- (a) Explain how you will deal with the following issues, giving journal entries where appropriate and giving clear explanations of how you arrive at your decisions. Make reference to relevant International Financial Reporting Standards where appropriate. Where there is a choice of treatment according to a standard, use the benchmark.

Note. Extracts from financial statements are **not** required.

- (i) On 19 December 20X1 a customer called Intuoso Co complained that goods delivered and paid for in advance were the wrong colour. You did not have the correct colour in inventory and therefore agreed to refund the money when the goods were returned. The goods were returned on 3 January 20X2. The goods had cost \$2,000 and had been sold at a mark up of 20%. **(4 marks)**
- (ii) A customer called Fortissimo Co claims that it has lost business due to the poor quality of goods supplied by Belloso Co. Your lawyer advises you that it is likely that Fortissimo Co will win the legal case and that Belloso Co will have to pay \$10,000 if this happens. **(4 marks)**
- (iii) A customer called Changeoso Co owed Belloso Co \$12,000 in respect of sales made several years ago. During 20X0 Changeoso Co went into liquidation and the \$12,000 was written off in that year as an irrecoverable debt.
- However, the liquidators advise you it is probable, though not reasonably certain, that Belloso Co will receive \$4,000 when the legalities are finalised during 20X2. **(3 marks)**
- (iv) In the financial statements for the year ended 31 December 20X0 closing inventory was valued at \$32,600. However, in January 20X1 inventory that had cost \$17,000 was found in a location that had not been covered by the inventory count. Profit in the year to 31 December 20X0 had been calculated as \$28,000. **(4 marks)**

- (b) In addition, you have the following information:

Retained earnings at 1 January 20X0	\$52,000
Profit for the year ended 31 December 20X0	\$28,000

Prepare the statement of changes in equity (retained earnings only) for Belloso Co for the year ended 31 December 20X1, including comparatives, after adjusting for the above issues. **(5 marks)**

(Total = 20 marks)

44 Epsilon 3 (12/05)

39 mins

You are the accountant of Epsilon, an entity that has business interests all around the world. The financial statements for the year ended 30 September 20X5 are currently in the process of preparation. The directors have sought your advice on the financial reporting implications of the following issues:

- (a) On 31 August 20X5 the directors decided to close down a business segment. The decision was taken out of a desire to refocus the strategic direction of the group and the segment being closed did not fit into the new strategy. The closure commenced on 15 October 20X5 and was due to be completed on 31 December 20X5. On 10 September 20X5 letters were sent to employees offering voluntary redundancy or redeployment in other sectors of the business. On 13 September 20X5 negotiations commenced with relevant parties with a view to terminating existing contracts of the business segment and arranging sales of its assets. Latest estimates of the financial implications of the closure are as follows:

- (i) Redundancy costs will total \$20m.
 - (ii) The pension plan will make a lump sum payment totalling \$10m to the employees who accept voluntary redundancy in termination of their rights under the plan. Epsilon will pay this amount into the plan on 31 January 20X6.
 - (iii) The cost of redeploying and retraining staff who do not accept redundancy will total \$6.5m.
 - (iv) The costs of terminating existing contracts, including professional fees, will total \$5m.
 - (v) Plant having a carrying amount of \$12m at 30 September 20X5 will be sold for \$1m.
 - (vi) A freehold property having a carrying amount of \$10m at 30 September 20X5 will be sold for \$15m. The potential purchaser is not interested in acquiring the plant.
 - (vii) The operating losses of the business segment for October, November and December 20X5 will total \$9m. (12 marks)
- (b) Epsilon has a subsidiary located in Farland. Farland has its own tax jurisdiction and no other group entity is located within it. The subsidiary regularly sells goods to Epsilon and the inventory of Epsilon at 30 September 20X5 included goods purchased from its subsidiary on which its subsidiary had made a profit of \$1m (after translation at the appropriate rate). The subsidiary had made a loss adjusted for tax purposes for the year ended 30 September 20X5 that was equivalent to \$4m. Local tax legislation only allows tax losses to be carried forward for relief against future trading profits. The directors of Epsilon consider that the loss of the subsidiary is due to identifiable non-recurring causes and that the subsidiary will record a taxable profit for the foreseeable future. Both Epsilon and its subsidiary pay tax at 30%. (8 marks)

Required

Advise the directors on the financial reporting implications of the issues in the consolidated financial statements for the year ended 30 September 20X5. For each issue you should indicate the amounts that would be included in the financial statements and the nature of any disclosures that might be appropriate in the notes. You should justify your conclusion with reference to appropriate International Financial Reporting Standards and include any other explanations you consider relevant.

The allocation of marks to each individual issue is given above after the description of the issue.

(Total = 20 marks)

45 Omega 11 (2011 Pilot Exam)

39 mins

You are the accountant of Omega, an entity that has business interests all around the world. The financial statements for the year ended 31 March 20X1 are currently in the process of preparation. The directors have sought your advice on the financial reporting implications of the following issues:

Issue 1

On 28 February 20X1 the directors decided to close down a business segment. The decision was taken out of a desire to refocus the strategic direction of the group and the segment being closed did not fit in to the new strategy. The closure commenced on 5 April 20X1 and was due to be completed on 31 July 20X1. On 6 March 20X1 letters were sent to employees offering voluntary redundancy or redeployment in other sectors of the business. On 13 March 20X1 negotiations commenced with relevant parties with a view to terminating existing contracts of the business segment and arranging sales of its assets. Latest estimates of the financial implications of the closure are as follows:

- (a) Redundancy costs will total \$20m, excluding the payment referred to in (b) below.
- (b) The pension plan (a defined benefit plan) will make a lump sum payment totalling \$10m to the employees who accept voluntary redundancy in termination of their rights under the plan. Omega will pay this amount into the plan on 31 July 20X1. The actuaries have advised that the accumulated pension rights that this payment will extinguish have a present value of \$7.5m and this sum is unlikely to alter significantly before 31 July 20X1.

QUESTIONS

- (c) The cost of redeploying and retraining staff who do not accept redundancy will total \$5.5m.
- (d) The costs of terminating existing contracts, including professional fees, will total \$5m.
- (e) Plant having a carrying amount of \$11m at 31 March 20X1 will be sold for \$2m.
- (f) A freehold property having a carrying amount of \$10m at 31 March 20X1 will be sold for \$15m. The potential purchaser is not interested in acquiring the plant.
- (g) The operating losses of the business segment for April, May and June 20X1 will total \$9m. **(14 marks)**

Issue 2

On 1 October 20X0 Omega granted 250,000 options that allowed employees to purchase shares for \$10 per share. The options are to vest on 30 June 20X1 provided the employees satisfy certain performance conditions in the nine-month period between 1 October 20X0 and 30 June 20X1. The market value of the shares on 1 October 20X0 was only \$10, although by 30 June 20X1 the market value was expected to rise to \$12. The fair value of each share option was estimated to be \$1.80 per share at 1 October 20X0. This estimate had increased to \$1.90 per share by 31 March 20X1. On 1 October 20X0 it was anticipated that all the options would vest. However, employee performance in the period since 1 October 20X0 has been such that it is now likely that only 200,000 of the options will vest. **(6 marks)**

Required

Advise the directors on the financial reporting implications of the two issues in the consolidated financial statements for the year ended 31 March 20X1. For each issue you should indicate the amounts that would be included in the financial statements and the nature of any disclosures that might be appropriate in the notes. You should justify your conclusion with reference to appropriate International Financial Reporting Standards and include any other explanations you consider relevant.

The allocation of marks to each individual issue is given above after the description of the issue.

(Total = 20 marks)

46 Delta (12/13) (amended)

39 mins

Delta is an entity which prepares financial statements to 30 September each year. Each year the financial statements are authorised for issue on 30 November. During the year ended 30 September 20X3 the following transactions occurred:

- (a) On 1 April 20X3, Delta subscribed for 40 million \$1 loan notes in Epsilon. The loan notes were issued at 90 cents and under the terms of issue were redeemable at \$1.20 on 31 March 20X8. Interest is payable on 31 March in arrears at 4% of par value. This represents an effective annual rate of return for Delta of 9.9%. Delta's intention is to hold the loan notes until redemption. **(7 marks)**
- (b) On 1 June 20X3, Delta decided to dispose of the trade and assets of a business it had acquired several years previously. This disposal does not involve Delta withdrawing from a particular market sector. The carrying amounts on 1 June 20X3 of the assets to be disposed of were as follows:

	\$m
Goodwill	10
Property, plant and equipment	20
Patents and trademarks	8
Inventories	15
Trade receivables	10
	<u>63</u>

Delta offered the business for sale at a price of \$46.5m, which was considered to be reasonably achievable. Delta estimated that the direct costs of selling the business would be \$500,000. These estimates have not changed since 1 June 20X3 and Delta estimates that the business will be sold by 31 March 20X4 at the latest.

None of the assets of the business had suffered obvious impairment at 1 June 20X3. At that date the inventories and trade receivables of the business were already stated at no more than their recoverable amounts. (7 marks)

- (c) During the year Delta entered into two lease arrangements:
- (i) A nine-month lease of an item of plant commencing on 1 August 20X3. A payment of \$180,000 was made on 1 August 20X3. The useful life of the plant is five years.
 - (ii) A four year lease of 500 tablet computers for its staff. The market price of each tablet is approximately \$800, with a useful life of four years. Lease payments of \$240 per year per tablet are payable in advance, commencing on 1 April 20X3. The present value of the lease payments is \$800 per tablet computer, equivalent to a finance rate of 13.7% per annum.

Delta's accounting policy is to apply any optional exemptions permitted by IFRS 16 *Leases*. (6 marks)

Required

Explain and show (where possible by quantifying amounts) how the three events would be reported in the financial statements of Delta for the year ended 30 September 20X3. You do not need to quantify amounts which are only shown in the notes to the financial statements.

Note. The mark allocation is shown against each of the three events above.

You should assume that all transactions described here are material.

(Total = 20 marks)

47 Kappa 6 (12/10)

39 mins

- (a) IAS 33 *Earnings per Share* requires certain entities to disclose information about earnings per share (EPS) in their financial statements.

Required

Describe:

- (i) Those entities to which IAS 33 applies
 - (ii) The way in which EPS (both basic and diluted) should be computed – in outline **only**
 - (iii) The numerical disclosure requirements regarding EPS for entities that have no discontinued operations
 - (iv) The additional numerical disclosure requirements regarding EPS for entities that report discontinued operations (7 marks)
- (b) Kappa is a listed entity that made a profit after tax of \$35m for the year ended 30 September 20X7. There were no discontinued operations. At 1 October 20X6 Kappa had 70 million ordinary shares and 30 million preferred shares in issue. The preferred shares were correctly presented in equity within the statement of financial position. In the year ended 30 September 20X7 Kappa declared and paid a dividend of 12 cents per share to the ordinary shareholders and 6 cents per share to the preferred shareholders.

On 31 December 20X6 Kappa made a fully subscribed rights issue of 2 ordinary shares for every 7 held at \$1.35 per share. The fair value of an ordinary share at 31 December 20X6 was \$1.80.

Throughout the financial year Kappa had 20 million convertible loan notes on which interest of 5 cents per note was payable annually in arrears. The carrying amount of the liability element of the loan note at 1 October 20X6 was \$23m and the effective rate of interest was 7%. The rate of income tax in the jurisdiction in which Kappa operates is 20% and the finance cost that is charged in the statement of profit or loss and other comprehensive income is subject to income tax at that rate.

The notes are convertible into ordinary shares from 1 October 20X8 at the option of the note-holder. The conversion terms are one ordinary share for every loan note held.

Required

Compute the basic and diluted EPS of Kappa for the year ended 30 September 20X7.

(8 marks)

- (c) On 1 October 20X5 Kappa granted share options to 500 sales staff. The entitlement of each member of staff depended on the achievement of overall sales targets in the three-year period to 30 September 20X8. Details are as follows:

- Cumulative sales less than \$100m: 100 options each
- Cumulative sales between \$100m and \$150m: 150 options each
- Cumulative sales more than \$150m: 200 options each

The options had a fair value of \$1.20 per option on 1 October 20X5. This had increased to \$1.30 per option by 30 September 20X6 and by 30 September 20X7 the fair value of an option was \$1.35 per option.

When the options were granted and at 30 September 20X6 management estimated that total sales in the three-year period would be \$130m. However, following a very good year in the year to 30 September 20X7 that estimate was revised to \$160m.

Required

Compute the charge to the statement of profit or loss and other comprehensive income for the year ended 30 September 20X7 in respect of the above arrangement and the amount included in the statement of financial position at 30 September 20X7.

(5 marks)

(Total = 20 marks)

48 Townsend

39 mins

- (a) The issued share capital of Townsend, a publicly listed company, at 31 March 20X3 was \$10 million. Its shares are denominated at 25 cents each. Townsend's earnings attributable to its ordinary shareholders for the year ended 31 March 20X3 were also \$10 million, giving an earnings per share of 25 cents.

Year ended 31 March 20X4

On 1 July 20X3 Townsend issued eight million ordinary shares at full market value. On 1 January 20X4 a bonus issue of one new ordinary share for every four ordinary shares held was made. Earnings attributable to ordinary shareholders for the year ended 31 March 20X4 were \$13,800,000.

Year ended 31 March 20X5

On 1 October 20X4 Townsend made a rights issue of shares of two new ordinary shares at a price of \$1.00 each for every five ordinary shares held. The offer was fully subscribed. The market price of Townsend's ordinary shares immediately prior to the offer was \$2.40 each. Earnings attributable to ordinary shareholders for the year ended 31 March 20X5 were \$19,500,000.

Required

Calculate Townsend's earnings per share for the years ended 31 March 20X4 and 20X5 including comparative figures.

(9 marks)

- (b) On 1 April 20X5 Townsend issued \$20 million 10% convertible loan stock at par. The terms of conversion (on 1 April 20X8) are that for every \$100 of loan stock, 25 ordinary shares will be issued at the option of loan stockholders. Alternatively the loan stock will be redeemed at par for cash. Also on 1 April 20X5 the directors of Townsend were awarded share options on 12 million ordinary shares exercisable from 1 April 20X8 at \$1.50 per share. The average market value of Townsend's ordinary shares for the year ended 31 March 20X6 was \$2.50 each. The income tax rate is 20%. Earnings attributable to ordinary shareholders for the year ended 31 March 20X6 were \$25,200,000. The share options have been correctly recorded in the financial statements.

Required

Calculate Townsend's basic and diluted earnings per share for the year ended 31 March 20X6 (comparative figures are not required). **(5 marks)**

- (c) Discuss the view that the basic EPS should be based upon not only existing issued shares but also on other shares which are in substance 'share equivalents' and have a dilutive effect on the basic EPS. **(6 marks)**

(Total = 20 marks)

49 RP Group

39 mins

Related party relationships and transactions are a normal feature of business. Entities often carry on their business activities through subsidiaries and associates and it is inevitable that transactions will occur between group companies. Until relatively recently the disclosure of related party relationships and transactions has been regarded as an area which has a relatively low priority. However, financial scandals have emphasised the importance of an accounting standard in this area.

Required

- (a) (i) Explain why the disclosure of related party relationships and transactions is an important issue. **(6 marks)**
- (ii) Discuss the view that small companies should be exempt from the disclosure of related party relationships and transactions on the grounds of their size. **(4 marks)**
- (b) Discuss whether the following events would require disclosure in the financial statements of the RP Group, a public limited company, under IAS 24 *Related Party Disclosures*.

The RP Group, investment bankers, has a number of subsidiaries, associates and joint arrangements in its group structure. During the financial year to 31 October 20X9 the following events occurred.

- (i) The company agreed to finance a management buyout of a group company, AB, a limited company. In addition to providing loan finance, the company has retained a 25% equity holding in the company and has a main board director on the board of AB. RP received management fees, interest payments and dividends from AB. **(6 marks)**
- (ii) On 1 July 20X9, RP sold a wholly owned subsidiary, X, a limited company, to Z, a public limited company. During the year RP supplied X with second hand office equipment and X leased its factory from RP. The transactions were all contracted for at market rates. **(4 marks)**

(Total = 20 marks)

50 Omega (6/13)

39 mins

You are the financial controller of Omega, a listed company which prepares consolidated financial statements in accordance with International Financial Reporting Standards (IFRS). Your managing director, who is not an accountant, has recently attended a seminar and has prepared a number of questions for you concerning two issues raised at the seminar:

QUESTIONS

- (a) 'I was confused regarding a number of references to fair value and a new accounting standard on the subject. I thought financial statements were prepared on a historical cost basis. Please give me three examples of where fair value might be relevant for us. I was told the new standard removed an inconsistency in the definition of fair value and applied three levels of input into the measurement of fair value. Please explain how the new standard defines fair value and what the previous inconsistency was. Please also explain each level of input and how each level is applied in measuring the fair value of a particular item in the financial statements.' (10 marks)
- (b) 'One of the topics discussed at the seminar was segment reporting. I believe I heard someone say that segment reporting varies from company to company depending on its internal structure. Please explain how we should identify the segments we use to provide our segment reporting information. I do not need to know the detailed content of a segment report.' (10 marks)

Required

Provide answers to the questions raised by the managing director.

Note. The mark allocation is shown against each of the two issues above.

(Total = 20 marks)

51 Omega (12/14)

39 mins

You are the financial controller of Omega, a listed entity which prepares consolidated financial statements in accordance with International Financial Reporting Standards (IFRS). The managing director, who is not an accountant, has recently been appointed. She formerly worked for Rival, one of Omega's key competitors. She has reviewed the financial statements of Omega for the year ended 30 September 20X4 and has prepared a series of queries relating to those statements:

Query One

'I was very confused by the note that included financial information relating to our operating segments. This note bears very little resemblance to the equivalent note included in the financial statements of Rival. Please explain how the two notes can be so different.' (8 marks)

Query Two

'The notes to our financial statements refer to equity settled share-based payments relating to the granting of share options. When I joined Omega, I was granted share options but I can only exercise those options if I achieve certain performance targets in my first three years as managing director. I know that other directors are also granted similar option arrangements. I don't see why they affect the financial statements when the options are granted though, because no cash is involved unless the options are exercised. Please explain to me exactly what is meant by an 'equity settled share-based payment'. Please also explain how, and when, equity settled share-based payments affect the financial statements of entities that grant them to their employees. I would like to know how such 'payments' are measured, over what period the 'payments' are recognised, and exactly what accounting entries are involved.' (8 marks)

Query Three

'I was confused when I looked at the statement of financial position and saw that the assets and liabilities were divided up into three sections and not two. The current and non-current sections I understand but I don't understand the 'non-current assets held for sale' and 'liabilities directly associated with non-current assets held for sale' sections. Please explain the meaning and accounting treatment of a non-current asset held for sale. Please also explain how there can be liabilities directly associated with non-current assets held for sale.' (4 marks)

Required

Provide answers to the three queries raised by the managing director. Your answers should refer to relevant provisions of International Financial Reporting Standards.

Note. The mark allocation is shown against each of the three issues above.

(Total = 20 marks)

52 Whitebirk

39 mins

- (a) The principal aim when developing accounting standards for small to medium-sized enterprises (SMEs) is to provide a framework that generates relevant, reliable, and useful information which should provide a high quality and understandable set of accounting standards suitable for SMEs. There is no universally agreed definition of an SME and it is difficult for a single definition to capture all the dimensions of a small or medium-sized business. The main argument for separate SME accounting standards is the undue cost burden of reporting, which is proportionately heavier for smaller firms.

Required

- (i) Comment on the different approaches which could have been taken by the International Accounting Standards Board (IASB) in developing the *IFRS for Small and Medium-sized Entities (IFRS for SMEs)*, explaining the approach finally taken by the IASB. (6 marks)
 - (ii) Discuss the main differences and modifications to IFRS which the IASB made to reduce the burden of reporting for SME's, giving specific examples where possible and include in your discussion how the Board has dealt with the problem of defining an SME. (8 marks)
- (b) Whitebirk has met the definition of a SME in its jurisdiction and wishes to comply with the *IFRS for Small and Medium-sized Entities*. The entity wishes to seek advice on how it will deal with the following accounting issues in its financial statements for the year ended 30 November 2010. The entity currently prepares its financial statements under full IFRS.
- (i) Whitebirk purchased 90% of Close, a SME, on 1 December 20X1. The purchase consideration was \$5.7m and the value of Close's identifiable assets was \$6m. The value of the non-controlling interest at 1 December 2009 was measured at \$0.7m. Whitebirk has used the full goodwill method to account for business combinations and the life of goodwill cannot be estimated with any accuracy. Whitebirk wishes to know how to account for goodwill under the *IFRS for SMEs*.
 - (ii) Whitebirk has incurred \$1m of research expenditure to develop a new product in the year to 30 November 20X2. Additionally, it incurred \$500,000 of development expenditure to bring another product to a stage where it is ready to be marketed and sold.

Required

Discuss how the above transactions should be dealt with in the financial statements of Whitebirk, with reference to the *IFRS for Small and Medium-sized Entities*.

(6 marks)

(Total = 20 marks)

53 Alpha Group 10 (6/12)

78 mins

Alpha holds investments in two other entities, Beta and Gamma. The statements of financial position of the three entities at 31 March 20X2 were as follows:

	Alpha \$'000	Beta \$'000	Gamma \$'000
ASSETS			
<i>Non-current assets:</i>			
Property, plant and equipment (Note 1)	267,000	250,000	220,000
Investments (Notes 1 and 4)	263,349	Nil	Nil
	<u>530,349</u>	<u>250,000</u>	<u>220,000</u>
<i>Current assets:</i>			
Inventories (Note 5)	85,000	50,000	40,000
Trade receivables (Note 6)	75,000	45,000	36,000
Cash and cash equivalents	15,000	10,000	8,000
	<u>175,000</u>	<u>105,000</u>	<u>84,000</u>
Total assets	<u>705,349</u>	<u>355,000</u>	<u>304,000</u>

	Alpha \$'000	Beta \$'000	Gamma \$'000
EQUITY AND LIABILITIES			
<i>Equity</i>			
Share capital (\$1 shares)	195,000	100,000	80,000
Retained earnings	281,167	100,000	100,000
Other components of equity (Note 2)	Nil	55,000	Nil
Total equity	<u>476,167</u>	<u>255,000</u>	<u>180,000</u>
<i>Non-current liabilities:</i>			
Deferred consideration (Note 1)	61,983	Nil	Nil
Pension liability (Note 7)	35,000	Nil	Nil
Long-term borrowings (Note 8)	60,000	45,000	50,000
Deferred tax	21,199	15,000	20,000
Total non-current liabilities	<u>178,182</u>	<u>60,000</u>	<u>70,000</u>
<i>Current liabilities:</i>			
Trade and other payables (Note 6)	35,000	30,000	34,000
Short-term borrowings	16,000	10,000	20,000
Total current liabilities	<u>51,000</u>	<u>40,000</u>	<u>54,000</u>
Total equity and liabilities	<u>705,349</u>	<u>355,000</u>	<u>304,000</u>

Note 1 – Alpha's investment in Beta

On 1 April 20X0, Alpha acquired 75 million shares in Beta by means of a share exchange. The terms of the business combination were as follows:

- Alpha issued two shares for every three shares acquired in Beta. On 1 April 20X0, the market value of an Alpha share was \$3.50.
- Alpha will make a deferred cash payment to the former shareholders of Beta on 31 March 20X3 of \$1 per Beta share acquired. On 1 April 20X0, Alpha's incremental borrowing rate was 10% per annum. Alpha has included a liability of \$61,983,471 in respect of this deferred payment in its statement of financial position as at 31 March 20X2.

It is the group policy to value the non-controlling interest in subsidiaries at the date of acquisition at fair value. The market value of an equity share in Beta at 1 April 20X0 can be used for this purpose. On 1 April 20X0, the market value of a Beta share was \$2.00.

On 1 April 20X0, the individual financial statements of Beta showed the following reserves balances:

- Retained earnings \$45m
- Other components of equity \$35m

The directors of Alpha carried out a fair value exercise to measure the identifiable assets and liabilities of Beta at 1 April 20X0. The following matters emerged:

- Plant and equipment having a carrying amount of \$100m had an estimated market value of \$110m. The estimated future useful life of the plant at 1 April 20X0 was five years and this estimate remains valid. Beta has disposed of 20% of this plant and equipment since 1 April 20X0.
- Inventory having a carrying amount of \$35m had an estimated market value of \$38m. This inventory had been sold since 1 April 20X0.

The fair value adjustments have not been reflected in the individual financial statements of Beta. In the consolidated financial statements the fair value adjustments will be regarded as temporary differences for the purposes of computing deferred tax. The rate of tax to apply to temporary differences where required is 20%.



Note 2 – Other components of equity

The other components of Beta's equity arise due to its policy of measuring property using the revaluation model. Beta revalued its property as at 1 April 20X0 so the carrying amount at that date in Beta's financial statements represented its fair value. Beta does not make any transfer of the revaluation surplus to retained earnings as the property is used. Beta did not revalue the property again until 31 March 20X2. The depreciation charge on the property in the financial statements of Beta for the year ended 31 March 20X2 was based on the carrying amount of the property as at 1 April 20X0. The revaluation of the property at 31 March 20X2 created a gross surplus of \$25m on which Beta recognised a deferred tax liability (at 20%) of \$5m. Therefore Beta credited \$20m to other components of equity on 31 March 20X2. Alpha measures its property, plant and equipment using the cost model. The policy of Alpha is to be applied in preparing the consolidated financial statements.

Note 3 – Impairment reviews – Beta

On 1 April 20X0, the directors of Alpha identified that Beta comprised four cash-generating units, unit 1, unit 2, unit 3 and unit 4. The directors of Alpha allocated the goodwill arising on the acquisition across the units in the ratio 2:1:1:1 respectively.

During the year ended 31 March 20X2, three of the four cash-generating units performed very satisfactorily and no impairment of the goodwill allocated to these units had occurred. However, the performance of the unit 4 was below expectations. At 31 March 20X2, the assets (excluding goodwill) of unit 4 had a carrying amount in the consolidated financial statements of \$70m. The recoverable amount of the assets of unit 4 at 31 March 20X2 was estimated at \$75m.

Note 4 – Alpha's investment in Gamma

On the date of incorporation of Gamma, Alpha subscribed for 40% of the equity shares of Gamma, making a payment of \$32m in cash. This investment made Gamma a joint venture. The draft financial statements of Alpha recognise this investment at cost.

You can ignore any deferred tax implications of the investment by Alpha in Gamma.

Note 5 – Inter-company sale of inventories

The inventories of Beta and Gamma at 31 March 20X2 included components purchased from Alpha during the year at a cost of \$15m to Beta and \$12.5m to Gamma. Alpha applied a mark-up of 25% of its production cost in arriving at the sale price of these components. You can ignore the deferred tax implications of any adjustments you make due to the information in this note.

Note 6 – Trade receivables and payables

The trade receivables of Alpha included \$8m receivable from Beta and \$6m receivable from Gamma in respect of the purchase of components (see Note 5). The trade payables of Beta and Gamma included equivalent amounts payable to Alpha.

Note 7 – Employee benefits

Alpha has established a defined benefit retirement benefits plan for its employees. Its statement of financial position at 31 March 20X1 showed a net liability of \$60m in respect of this plan, comprising:

- Pension obligation \$140m
- Fair value of plan assets \$80m

Relevant data for the plan for year ended 31 March 20X2 is as follows:

- Current service cost \$28m
- Interest cost on net plan liabilities \$2m
- Contributions paid into the plan by Alpha \$25m
- Benefits paid by the plan to plan members \$9m
- Actuarial loss on net plan liabilities \$1m

The only accounting entry made by Alpha in respect of the plan in its draft financial statements of the current period was to debit the net pension liability with the contributions paid into the plan. Actuarial gains and losses are recognised in other comprehensive income as they arise. You can ignore the deferred tax implications of any adjustments you make due to the information in this note.

Note 8 – Long-term borrowings

The long-term borrowings of Alpha arose on 1 April 20X1 when Alpha borrowed €50m. Alpha incurred issue costs of €1m. The exchange rate at 1 April 20X1 was \$1.20 = €1. On 1 April 20X1 Alpha included \$60m in long-term borrowings and charged \$1.2m to comprehensive income.

The borrowing requires Alpha to make annual interest payments in arrears of €4m. The exchange rate on 31 March 20X2 was \$1.25 = €1. Alpha therefore charged a finance cost of \$5m to comprehensive income on 31 March 20X2.

The loan is repayable by Alpha on 31 March 20X6 at an amount of €58m. The effective annual interest rate applicable to this loan is 11.1%. Other than as described in this note, Alpha has made no other accounting entries relating to this loan. You can ignore the deferred tax implications of any adjustments you make due to the information in this note.

Required

Prepare the consolidated statement of financial position of Alpha at 31 March 20X2.

(40 marks)

54 Alpha (6/13)

78 mins

Alpha holds investments in two other entities, Beta and Gamma. The statements of financial position of the three entities at 31 March 20X3 were as follows:

	<i>Alpha</i> \$'000	<i>Beta</i> \$'000	<i>Gamma</i> \$'000
ASSETS			
<i>Non-current assets</i>			
Property, plant and equipment (Note 1)	280,000	225,000	200,000
Right-of-use assets (Note 7)	108,000	Nil	Nil
Investments (Notes 1, 2 and 3)	78,500	40,000	10,000
	<u>466,500</u>	<u>265,000</u>	<u>210,000</u>
<i>Current assets</i>			
Inventories (Note 4)	85,000	56,000	42,000
Trade receivables (Note 5)	70,000	42,000	38,000
Cash and cash equivalents	14,000	11,000	9,000
	<u>169,000</u>	<u>109,000</u>	<u>89,000</u>
<i>Total assets</i>	<u>635,500</u>	<u>374,000</u>	<u>299,000</u>
EQUITY AND LIABILITIES			
<i>Equity</i>			
Share capital (\$1 shares)	160,000	120,000	100,000
Retained earnings	207,396	115,000	76,000
Other components of equity (Notes 2, 3 and 6)	5,604	4,000	2,000
<i>Total equity</i>	<u>373,000</u>	<u>239,000</u>	<u>178,000</u>
<i>Non-current liabilities</i>			
Provision (Note 7)	1,500	Nil	Nil
Lease liability	103,000	Nil	Nil
Long-term borrowings (Note 8)	60,000	50,000	60,000
Deferred tax	22,000	25,000	17,000
<i>Total non-current liabilities</i>	<u>186,500</u>	<u>75,000</u>	<u>77,000</u>

	Alpha \$'000	Beta \$'000	Gamma \$'000
<i>Current liabilities</i>			
Lease liability	9,000	Nil	Nil
Trade and other payables (Note 5)	45,000	40,000	34,000
Short-term borrowings	22,000	20,000	10,000
<i>Total current liabilities</i>	<u>76,000</u>	<u>60,000</u>	<u>44,000</u>
<i>Total equity and liabilities</i>	<u>635,500</u>	<u>374,000</u>	<u>299,000</u>

Note 1 – Alpha's investment in Beta

On 1 April 20X2, Alpha acquired 90 million shares in Beta by means of a share exchange. The terms of the business combination were as follows:

- Alpha issued eight shares for every nine shares acquired in Beta. On 1 April 20X2, the market value of an Alpha share was \$2.80.
- Alpha will make a further cash payment to the former shareholders of Beta on 30 June 20X5. This payment will be based on the adjusted profits of Beta for the three-year period to 31 March 20X5. On 1 April 20X2, the fair value of this additional payment was estimated at \$25m. This estimate had increased to \$28m by 31 March 20X3 due to changes in circumstances since the date of acquisition.
- Neither component of the investment in Beta has been recorded in the draft financial statements of Alpha presented above.

It is the group policy to value the non-controlling interest in subsidiaries at the date of acquisition at fair value. The market value of an equity share in Beta at 1 April 20X2 can be used for this purpose. On 1 April 20X2, the market value of a Beta share was \$2.60.

On 1 April 20X2, the individual financial statements of Beta showed the following reserves balances:

- Retained earnings \$86m
- Other components of equity \$2.4m

The directors of Alpha carried out a fair value exercise to measure the identifiable assets and liabilities of Beta at 1 April 20X2. The following matters emerged:

- Property having a carrying amount of \$140m (depreciable component \$80m) had an estimated market value of \$160m (depreciable component \$92m). The estimated future useful life of the depreciable component at 1 April 20X2 was 16 years and this estimate remains valid.
- Plant and equipment having a carrying amount of \$111m had an estimated market value of \$120m. The estimated future useful life of the plant and equipment at 1 April 20X2 was three years and this estimate remains valid. Beta has not disposed of any of this plant and equipment since 1 April 20X2.
- Intangible assets with an estimated market value of \$8m had not been recognised in the individual financial statements of Beta. The estimated future economic lives of these intangible assets at 1 April 20X2 was four years.
- The fair value adjustments have not been reflected in the individual financial statements of Beta. In the consolidated financial statements, the fair value adjustments will be regarded as temporary differences for the purposes of computing deferred tax. The rate of deferred tax to apply to temporary differences is 20%.

No impairment of the goodwill on acquisition of Beta has occurred since 1 April 20X2.

Note 2 – Alpha's investment in Gamma

On 1 April 20X2, Alpha acquired 40 million shares in Gamma for a cash payment of \$1.85 per share and debited \$74m to investments in its own statement of financial position. This enabled Alpha to exercise significant influence over Gamma but not to control Gamma. In its own financial statements, Alpha treated the investment in Gamma as a financial asset and made an election to measure it at fair value through other comprehensive income.



QUESTIONS

On 1 April 20X2, the individual financial statements of Gamma showed the following reserves balances:

- Retained earnings \$66m
- Other components of equity \$1.2m

On 1 April 20X2, there were no material differences between the carrying amounts of the net assets of Gamma in the individual financial statements and the fair values of those net assets.

On 31 March 20X3, the fair value of Alpha's investment in Gamma was estimated at \$78.5m and this is the balance recorded in Alpha's individual financial statements. On 31 March 20X3, Alpha credited \$4.5m to other components of equity. No deferred tax was recognised when making this entry.

In the consolidated financial statements you can ignore deferred tax when measuring the investment in Gamma.

Note 3 – Investments by Beta and Gamma

These investments are financial assets that are measured at fair value through other comprehensive income and have been correctly treated by Beta and Gamma. The other components of equity of Beta and Gamma relate entirely to these investments.

Note 4 – Inter-company sale of inventories

The inventories of Beta and Gamma at 31 March 20X3 included components produced by Alpha. The selling price of the components included in the inventories of Beta was \$14m. The selling price of the components included in the inventories of Gamma was \$12m. Alpha applied a mark-up of one-third of its production cost in arriving at the sales price of these components. You can ignore deferred tax when making any adjustments due to the information in this note.

Note 5 – Trade receivables and payables

The trade receivables of Alpha included \$9m receivable from Beta and \$7.5m receivable from Gamma in respect of the purchase of components (see Note 4). The trade payables of Beta and Gamma included equivalent amounts payable to Alpha.

Note 6 – Share based payment

On 1 April 20X1, Alpha granted share options to senior executives that are due to vest on 31 March 20X4. The maximum number of options that can vest is 10 million. However, there are vesting conditions that are service conditions. Each option allows the holder to purchase a share in Alpha for \$2.50. Further details are as follows:

<i>Date</i>	<i>Share price</i>	<i>Fair value of an option</i>	<i>Number of options expected to vest on 31 March 20X4</i>
1 April 20X1	\$2.50	36 cents	9 million
31 March 20X2	\$2.80	55 cents	9.2 million
31 March 20X3	\$3.00	90 cents	9.3 million

On 31 March 20X2, the directors of Alpha correctly credited other components of equity and debited profit or loss with \$1,104,000 in respect of these share options. No entries have been made in the financial statements since then in respect of the options.

Ignore any deferred tax implications of the granting of these share options.

Note 7 – Provision

On 1 October 20X1, Alpha entered into a ten-year lease of office premises at an annual rental of \$20m in arrears. This lease was appropriately accounted for in the financial statements.

On 1 October 20X1, Alpha began carrying out alterations to the premises. These alterations were completed on 31 March 20X2 at a total cost of \$18m. Alpha included \$18m in its property, plant and equipment at 31 March 20X2 and charged depreciation in the current year based on a 9½ year useful life.

The terms of the lease require Alpha to vacate the premises on 30 September 20Y1 and leave them in the same condition as they were on 1 October 20X1. The directors estimate that this will require restoration expenditure of

\$14,250,000 on 30 September 20Y1. Accordingly, the directors recognised a provision of \$1,500,000 (\$14,250,000/9.5) at 31 March 20X3. The directors debited \$1,500,000 to profit or loss when recognising this provision.

A relevant discount rate to use in any discounting calculations is 8% per annum. The present value of \$1 payable in 9½ years at this discount rate is 48 cents.

Note 8 – Long-term borrowings

The long-term borrowings of Alpha include \$20m that was received from a consortium of banks on 1 April 20X2. The loan does not carry any interest but \$30.6m is repayable on 31 March 20X7. Alpha incurred incremental costs of \$1m in arranging the loan which were charged to profit or loss in the year ended 31 March 20X3. The effective annual rate of interest applicable to this loan is 10%.

Required

Prepare the consolidated statement of financial position of Alpha at 31 March 20X3.

Note. You should show all workings to the nearest \$'000.

(40 marks)

55 Alpha Group (12/13)

78 mins

Alpha holds investments in two other entities, Beta and Gamma. The statements of financial position of the three entities at 30 September 20X3 were as follows:

	Alpha \$'000	Beta \$'000	Gamma \$'000
ASSETS			
<i>Non-current assets:</i>			
Property, plant and equipment (Notes 1 and 3)	320,000	235,000	220,000
Intangible assets (Notes 1 and 4)	55,000	60,000	Nil
Investments (Notes 1 and 2)	322,000	Nil	Nil
	<u>697,000</u>	<u>295,000</u>	<u>220,000</u>
<i>Current assets:</i>			
Inventories (Note 5)	88,000	61,000	42,000
Trade receivables (Note 6)	65,000	49,000	38,000
Cash and cash equivalents	12,000	10,000	9,000
	<u>165,000</u>	<u>120,000</u>	<u>89,000</u>
Total assets	<u>862,000</u>	<u>415,000</u>	<u>309,000</u>
EQUITY AND LIABILITIES			
<i>Equity</i>			
Share capital (\$1 shares)	195,000	150,000	120,000
Retained earnings	185,000	115,000	75,000
Other components of equity (Notes 2 and 3)	192,000	11,000	Nil
Total equity	<u>572,000</u>	<u>276,000</u>	<u>195,000</u>
<i>Non-current liabilities:</i>			
Long-term borrowings (Note 8)	170,000	54,000	50,000
Deferred tax	50,000	35,000	20,000
Total non-current liabilities	<u>220,000</u>	<u>89,000</u>	<u>70,000</u>
<i>Current liabilities:</i>			
Trade and other payables (Note 6)	48,000	45,000	34,000
Short-term borrowings	22,000	5,000	10,000
Total current liabilities	<u>70,000</u>	<u>50,000</u>	<u>44,000</u>
Total equity and liabilities	<u>862,000</u>	<u>415,000</u>	<u>309,000</u>

Note 1 – Alpha's investment in Beta

On 1 July 20X2, Alpha acquired 120 million shares in Beta by means of a share exchange. The terms of the business combination were as follows:

- Alpha issued five shares for every six shares acquired in Beta. On 1 July 20X2, the market value of an Alpha share was \$2.40. This share issue has been correctly reflected in the financial statements of Alpha.
- Alpha will make a further cash payment of \$50m to the former shareholders of Beta on 30 June 20X5. Alpha has made no entry in its financial statements in respect of this additional payment. At 1 July 20X2, Alpha's credit rating was such that it could have borrowed funds at an annual interest rate of 10%.

It is the group policy to value the non-controlling interest in subsidiaries at the date of acquisition at fair value. The market value of an equity share in Beta at 1 July 20X2 was \$1.70 and can be used for this purpose.

On 1 July 20X2, the individual financial statements of Beta showed the following reserves balances:

- Retained earnings \$98m
- Other components of equity \$5m (see Note 3 as follows)

The directors of Alpha carried out a fair value exercise to measure the identifiable assets and liabilities of Beta at 1 July 20X2. The following matters emerged:

- Plant and equipment having a carrying amount of \$120m had an estimated market value of \$130m. The estimated future useful life of the plant and equipment at 1 July 20X2 was four years and this estimate remains valid. Beta has disposed of 20% of this plant and equipment since 1 July 20X2.
- Intangible assets with an estimated market value of \$12m had not been recognised in the individual financial statements of Beta. At 1 July 20X2, the estimated future economic lives of these intangible assets was five years.

The fair value adjustments have not been reflected in the individual financial statements of Beta. In the consolidated financial statements the fair value adjustments will be regarded as temporary differences for the purposes of computing deferred tax. The rate of deferred tax to apply to temporary differences is 20%.

No impairment of the goodwill on acquisition of Beta has occurred since 1 July 20X2.

Note 2 – Alpha's investment in Gamma

On 1 October 20X2, Alpha acquired 48 million shares in Gamma for a total cash payment of \$80m. This share purchase followed an agreement with two other investors (who each purchased 36 million shares in Gamma on 1 October 20X2) to exercise joint control over Gamma. All key operating and financial policies, including the distribution of profits, require the unanimous consent of the three investors. In its own financial statements Alpha treated the investment in Gamma as a financial asset and made an election to measure it at fair value through other comprehensive income. On 30 September 20X3, the fair value of Alpha's investment in Gamma was \$82m. Alpha did not recognise any deferred tax in respect of this restatement to fair value. Therefore on 30 September 20X3 Alpha credited \$2m to other components of equity.

On 1 October 20X2, the individual financial statements of Gamma showed the following reserves balances:

- Retained earnings \$66m
- Other components of equity \$Nil

On 1 October 20X2, there were no material differences between the carrying amounts of the net assets of Gamma in the individual financial statements and the fair values of those net assets.

You do not need to consider the deferred tax implications of Alpha's investment in Gamma when preparing the consolidated statement of financial position of the Alpha group.

Note 3 – Property, plant and equipment of Beta

Beta measures its land under the revaluation model. The other components of equity of Beta consist entirely of revaluation surpluses arising on the revaluation of its land. On 1 July 20X2, the carrying amount of Beta's land in Beta's own financial statements was the same as its fair value. On 30 September 20X3, Beta revalued its land by \$7.5m. As a result of this revaluation, Beta recognised an additional deferred tax liability of \$1.5m and credited \$6m to other components of equity. The policy of Alpha and Gamma is to use the cost model to measure all property, plant and equipment. This is the policy to be adopted in the consolidated financial statements.

Note 4 – Intangible assets of Alpha and Beta

The intangible assets of Alpha comprise expenditure incurred during the year on a project to reduce wastage incurred during the group's production processes. The project began on 1 November 20X2 and is expected to be complete by 31 May 20X4. Expenditure to date has been \$5m each month. On 1 June 20X3, the directors were able to assess the technical feasibility and commercial viability of the project with reasonable certainty. At this date they also received assurance that the economic benefits the project was likely to bring to the group were likely to exceed the total project costs.

The intangible assets in the individual financial statements of Beta represent goodwill which arose on acquisition of an unincorporated business in 2008. No impairment of this goodwill has been necessary since the date of acquisition of Beta by Alpha.

Note 5 – Inter-company sale of inventories

The inventories of Beta and Gamma at 30 September 20X3 included components produced by Alpha. The selling price of the components included in the inventories of Beta was \$14m. The selling price of the components included in the inventories of Gamma was \$12m. Alpha applied a mark-up of one-third of its production cost in arriving at the sales price of these components. You can ignore deferred tax when making any adjustments due to the information in this note.

Note 6 – Trade receivables and payables

The trade receivables of Alpha included \$8m receivable from Beta and \$7m receivable from Gamma in respect of the purchase of components (see Note 5). The trade payables of Beta and Gamma included equivalent amounts payable to Alpha.

Note 7 – Forward currency contract

During July and August 20X3 Alpha conducted a large marketing effort in Country X. The currency in Country X is the Euro. Alpha made no sales to customers in Country X in the year ended 30 September 20X3 but is very confident of making substantial sales to such customers in the year ended 30 September 20X4. On 5 September 20X3, Alpha entered into a contract to sell €20m for \$28m on 31 October 20X3. Currency fluctuations in September 20X3 were such that on 30 September 20X3 the fair value of this currency contract was \$1.1m (a financial asset). The draft financial statements of Alpha do not include any amounts in respect of this currency contract since it has a zero cost. Alpha wishes to use hedge accounting whenever permitted by International Financial Reporting Standards. Alpha expects sales to customers in Country X to be at least €22m in October 20X3.

Note 8 – Long-term borrowings

The long-term borrowings of Alpha include a loan at a carrying amount of \$60m which was taken out on 1 October 20X2. The loan does not carry any interest but \$75.6m is repayable on 30 September 20X5. This represents an effective annual rate of return for the investors of 8%. As an alternative to repayment, the investors can exchange their loan asset for equity shares in Alpha on 30 September 20X5. The annual rate of return required by such investors on a non-convertible loan would have been 10%. Alpha has not charged any finance cost in respect of this loan for the year ended 30 September 20X3.

The present value of \$1 payable/receivable in three years' time is as follows:

- 79.4 cents when the discount rate is 8% per annum
- 75.1 cents when the discount rate is 10% per annum

Required

Prepare the consolidated statement of financial position of Alpha at 30 September 20X3.

Note. You should show all workings to the nearest \$'000.

(40 marks)

56 Epsilon (12/14)

39 mins

- (a) IFRS 3 *Business Combinations* prescribes the method of accounting to be used when an entity (the acquirer) obtains control of a business. Control is not defined in IFRS 3 but a definition is provided in IFRS 10 *Consolidated Financial Statements*.

Required

- (i) Define 'control' as outlined in IFRS 10. Where relevant, you should provide appropriate explanations for the terms you use in your definition. (4 marks)
 - (ii) Explain the way in which goodwill on acquisition and gains on bargain purchases should be initially computed and subsequently accounted for. (5 marks)
- (b) Epsilon prepares consolidated financial statements to 30 September each year. On 1 January 20X4, Epsilon acquired 75% of the equity shares of Kappa and gained control of Kappa. Kappa has 12 million equity shares in issue. Details of the purchase consideration are as follows:
- On 1 January 20X4, Epsilon issued two shares for every three shares acquired in Kappa. On 1 January 20X4, the market value of an equity share in Epsilon was \$6.50 and the market value of an equity share in Kappa was \$6.00.
 - On 31 December 20X4, Epsilon will make a cash payment of \$7.15m to the former shareholders of Kappa who sold their shares to Epsilon on 1 January 20X4. On 1 January 20X4, Epsilon would have needed to pay interest at an annual rate of 10% on borrowings.
 - On 31 December 20X5, Epsilon may make a cash payment of \$30m to the former shareholders of Kappa who sold their shares to Epsilon on 1 January 20X4. This payment is contingent upon the revenues of Epsilon growing by 15% over the two-year period from 1 January 20X4 to 31 December 20X5. On 1 January 20X4, the fair value of this contingent consideration was \$25m. On 30 September 2014, the fair value of the contingent consideration was \$22m.

On 1 January 20X4, the carrying amounts of the identifiable net assets of Kappa in the books of that company totalled \$60m. On 1 January 2014, the fair values of these net assets totalled \$70m. The rate of deferred tax to apply to temporary differences is 20%.

During the nine months ended on 30 September 20X4, Kappa had a poorer than expected operating performance. Therefore on 30 September 20X4 it was necessary for Epsilon to recognise an impairment of the goodwill arising on acquisition of Kappa, amounting to 10% of its total computed value.

Required

Compute the impairment of goodwill and explain how this impairment should be recognised in the consolidated financial statements of Epsilon. You should do this under **both** the methods permitted by IFRS 3 for the initial computation of the non-controlling interest in Kappa at the date of acquisition.

(11 marks)

(Total = 20 marks)

57 Alpha (6/15)**78 mins**

Alpha holds investments in two other entities, Beta and Gamma. The draft statements of financial position of the three entities at 31 March 20X5 were as follows:

	<i>Alpha</i> \$'000	<i>Beta</i> \$'000	<i>Gamma</i> \$'000
Assets			
Non-current assets:			
Property, plant and equipment (Notes 1 and 6)	300,000	240,000	180,000
Investments (Notes 1, 2 and 3)	<u>267,000</u>	<u>40,000</u>	<u>10,000</u>
	<u>567,000</u>	<u>280,000</u>	<u>190,000</u>
Current assets:			
Inventories (Note 4)	90,000	60,000	45,000
Trade receivables (Note 5)	72,000	46,000	40,000
Cash and cash equivalents	<u>15,000</u>	<u>10,000</u>	<u>8,000</u>
	<u>177,000</u>	<u>116,000</u>	<u>93,000</u>
Total assets	<u>744,000</u>	<u>396,000</u>	<u>283,000</u>
Equity and liabilities			
Equity			
Share capital (\$1 shares)	200,000	150,000	120,000
Retained earnings (Notes 1 and 2)	367,500	115,000	51,000
Other components of equity (Notes 1, 2 and 3)	<u>5,000</u>	<u>4,000</u>	<u>2,000</u>
Total equity	<u>572,500</u>	<u>269,000</u>	<u>173,000</u>
Non-current liabilities:			
Provision (Note 6)	12,500	Nil	Nil
Long-term borrowings (Note 7)	60,000	45,000	50,000
Deferred tax	<u>32,000</u>	<u>30,000</u>	<u>20,000</u>
Total non-current liabilities	<u>104,500</u>	<u>75,000</u>	<u>70,000</u>
Current liabilities:			
Trade and other payables (Note 5)	45,000	42,000	33,000
Short-term borrowings	<u>22,000</u>	<u>10,000</u>	<u>7,000</u>
Total current liabilities	<u>67,000</u>	<u>52,000</u>	<u>40,000</u>
Total equity and liabilities	<u>744,000</u>	<u>396,000</u>	<u>283,000</u>

Note 1 – Alpha's investment in Beta

On 1 April 20X0, Alpha acquired 120 million shares in Beta by means of a cash payment of \$234.5m. Alpha also incurred directly attributable costs of \$2.5m associated with the acquisition of Beta and recognised the investment in its individual statement of financial position at \$237m. There has been no change to the carrying value of this investment in Alpha's own statement of financial position since 1 April 20X0.

It is the group policy to value the non-controlling interest in subsidiaries at the date of acquisition at fair value. The market value of an equity share in Beta at 1 April 20X0 can be used for this purpose. On 1 April 20X0, the market value of a Beta share was \$1.80.

On 1 April 20X0, the individual financial statements of Beta showed the following reserves balances:

- Retained earnings \$75m
- Other components of equity \$1m

The directors of Alpha carried out a fair value exercise to measure the identifiable assets and liabilities of Beta at 1 April 20X0. The following matters emerged:

- Property having a carrying value of \$150m at 1 April 20X0 (depreciable component \$80m) had an estimated market value of \$180m at that date (depreciable component \$90m). The estimated future useful life of the depreciable component at 1 April 20X0 was 20 years. This property is included in Beta's statement of financial position at 31 March 20X5.

- Plant and equipment having a carrying value of \$110m at 1 April 20X0 had an estimated market value of \$123m at that date. Beta has disposed of all of this plant and equipment since 1 April 20X0.

The fair value adjustments have not been reflected in the individual financial statements of Beta. In the consolidated financial statements, the fair value adjustments will be regarded as temporary differences for the purposes of computing deferred tax. The rate of deferred tax to apply to temporary differences is 20%. No impairment of the goodwill on acquisition of Beta has occurred since 1 April 20X0.

Note 2 – Alpha's investment in Gamma

On 1 July 20X4, Alpha acquired 90 million shares in Gamma by means of a share exchange. Alpha issued two shares for every three shares acquired in Gamma. On 1 July 20X4, the market value of an Alpha share was \$2.90 and the market value of a Gamma share was \$1.50. The share exchange has not been recorded in the draft financial statements of Alpha presented above. Alpha also incurred directly attributable costs of \$1.5m associated with this acquisition and debited these costs to administrative expenses in its draft statement of profit or loss for the year ended 31 March 20X5.

On 1 April 20X4, the individual financial statements of Gamma showed the following reserves balances:

- Retained earnings \$45m. The profits of Gamma for the year ended 31 March 20X5 accrued evenly over the year.
- Other components of equity \$2m. See also the information provided in Note 3 regarding other components of equity.

On 1 July 20X4, there were no material differences between the carrying values of the net assets of Gamma in the individual financial statements and the fair values of those net assets.

No impairment of the goodwill on acquisition of Gamma has occurred since 1 July 20X4.

Note 3 – Other investments

Apart from its investment in Beta, the investments of Alpha included in the statement of financial position at 31 March 20X5 are all financial assets which Alpha has elected to measure at fair value through other comprehensive income. All of the investments held by Beta and Gamma are also financial assets which Beta and Gamma have elected to measure at fair value through other comprehensive income. None of these investments have been bought or sold in the year ended 31 March 20X5. The fair values which are included in the draft statements of financial position above are the fair values at 31 March 20X4 for Beta and 1 July 20X4 for Gamma. Relevant fair values as at 31 March 20X5 were as follows:

- Alpha – \$33m.
- Beta – \$43m.
- Gamma – \$11.6m. The change in the fair value of Gamma's investments during the year ended 31 March 20X5 was caused by events occurring **after** 1 July 20X4.

You do **not** need to consider the deferred tax implications of any gains arising on the remeasurement of these investments.

Note 4 – Inter-company sale of inventories

The inventories of Beta and Gamma at 31 March 20X5 included components purchased from Alpha in the last three months of the financial year at a cost of \$15m to Beta and \$10m to Gamma. Alpha normally earns a profit margin of 30% on the sale of these components but supplies of these components to group companies are routinely made at a reduced margin of 20%.

In the consolidated financial statements, any adjustments required as a result of this note will be regarded as temporary differences for the purposes of computing deferred tax. The rate of deferred tax to apply to temporary differences is 20%. You can assume that sufficient taxable profits exist in each entity to allow the deferred tax implications of deductible temporary differences.

Note 5 – Trade receivables and payables

The trade receivables of Alpha included \$9m receivable from Beta and \$6m receivable from Gamma in respect of the purchase of components (see Note 4). On 30 March 20X5, Beta and Gamma paid \$9m and \$6m respectively to Alpha and so eliminated their trade payables balance in respect of the purchase of components. Alpha recorded these receipts on 3 April 20X5.

Note 6 – Provision

On 1 March 20X5, the board of directors of Alpha finalised a plan to re-organise and reconstruct the group. The plan was publicly announced on 15 March 20X5. The plan involved closing down one of Alpha's operating units – unit X (not a separate legal entity). The business of unit X will not be discontinued – the other operating units of Alpha will be able to supply the unit's existing customers. However, all of the property, plant and equipment being used in unit X will be disposed of. Some of the employees working in unit X will be made redundant, and others will be transferred to other operating units of Alpha.

The provision made by Alpha in its draft financial statements comprised the best estimate of the following:

	\$m
Redundancy costs	8
Costs of relocating employees to new locations	2.5
Costs of retraining existing employees for work at new locations	<u>2.0</u>
	<u>12.5</u>

On 15 March 20X5, the property, plant and equipment of unit X, which is included in the above statement of financial position, had a total carrying value of \$15m. \$12m of this amount relates to property, and \$3m to plant and equipment. On 15 March 20X5, all of the property, plant and equipment was offered for sale. The property was offered for sale at a price of \$16.5m, and the plant and equipment at \$1.05m. Both of these amounts are considered to be reasonable prices which are achievable within six months of the year end. The estimated costs of disposal of the property are \$500,000 and the costs of disposal of the plant \$50,000. However, none of the property, plant and equipment of unit X which was being offered for sale had actually been sold by 31 March 20X5. You can assume that any change in carrying value of this property, plant and equipment between 15 and 31 March 20X5 is immaterial.

Note 7 – Long-term borrowings

On 31 March 20X5, Alpha issued 30 million \$1 convertible loan notes. The loan notes carry a coupon rate of 6% per annum payable annually in arrears and are redeemable at par on 31 March 20Y0. As an alternative to redemption, the loan note holders can elect to exchange their loan notes for equity shares in Alpha on 31 March 20Y0. If the option to exchange were not available, the investors in the loan notes would have required a return on their investment of 10% per annum.

Discount factors which may be relevant are as follows:

	Discount rate	
	6%	10%
	\$	\$
Present value of \$1 receivable in 5 years	0.747	0.621
Cumulative present value of \$1 receivable at the end of years 1–5	4.212	3.790

On 31 March 20X5, Alpha debited cash and credited long-term borrowings with \$30m in respect of this loan.

Required

Prepare the consolidated statement of financial position of Alpha at 31 March 20X5.

(40 marks)



58 Ayre (12/15)

78 mins

Ayre's investments include two subsidiaries, Bee and Cee. The draft statements of financial position of the three entities at 30 September 20X5 were as follows:

	Ayre \$'000	Bee \$'000	Cee \$'000
Assets			
Non-current assets:			
Property, plant and equipment (Notes 1 and 3)	380,000	355,000	152,000
Intangible assets (Note 1)	80,000	40,000	20,000
Investments (Notes 1, 3 and 4)	497,000	Nil	Nil
	<u>957,000</u>	<u>395,000</u>	<u>172,000</u>
Current assets:			
Inventories (Note 5)	100,000	70,000	65,000
Trade receivables (Note 6)	80,000	66,000	50,000
Cash and cash equivalents (Note 6)	10,000	15,000	10,000
	<u>190,000</u>	<u>151,000</u>	<u>125,000</u>
Total assets	<u>1,147,000</u>	<u>546,000</u>	<u>297,000</u>
Equity and liabilities			
Equity			
Share capital (50c shares)	150,000	200,000	120,000
Retained earnings (Notes 1 and 3)	498,000	186,000	60,000
Other components of equity (Notes 1, 3 and 4)	295,000	10,000	2,000
Total equity	<u>943,000</u>	<u>396,000</u>	<u>182,000</u>
Non-current liabilities:			
Provision (Note 7)	34,000	Nil	Nil
Long-term borrowings (Note 8)	60,000	50,000	45,000
Deferred tax	35,000	30,000	25,000
Total non-current liabilities	<u>129,000</u>	<u>80,000</u>	<u>70,000</u>
Current liabilities:			
Trade and other payables (Note 6)	50,000	55,000	35,000
Short-term borrowings	25,000	15,000	10,000
Total current liabilities	<u>75,000</u>	<u>70,000</u>	<u>45,000</u>
Total equity and liabilities	<u>1,147,000</u>	<u>546,000</u>	<u>297,000</u>

Note 1 – Ayre's investment in Bee

On 1 October 20X2, Ayre acquired 300 million shares in Bee by means of a share exchange of one share in Ayre for every two shares acquired in Bee. On 1 October 20X2, the market value of an Ayre share was \$2.40. Ayre incurred directly attributable costs of \$2m on acquisition of Bee. These costs comprised:

- \$0.8m – cost of issuing own shares, debited to Ayre's share premium account within other components of equity
- \$1.2m due diligence costs – included in the carrying amount of the investment in Bee in Ayre's own statement of financial position

There has been no change to the carrying amount of this investment in Ayre's own statement of financial position since 1 October 20X2.

On 1 October 20X2, the individual financial statements of Bee showed the following reserves balances:

- Retained earnings \$125m
- Other components of equity \$10m



The directors of Ayre carried out a fair value exercise to measure the identifiable assets and liabilities of Bee at 1 October 20X2. The following matters emerged:

- Plant and equipment having a carrying amount of \$295m had an estimated market value of \$340m. The estimated remaining useful economic life of this plant at 1 October 20X2 was five years. None of this plant and equipment had been disposed of between 1 October 20X2 and 30 September 20X5.
- An in-process research and development project existed at 1 October 20X2 but did not meet the recognition criteria of IAS 38 *Intangible Assets*. The fair value of the research and development project at 1 October 20X2 was \$20m. The project started to generate economic benefits on 1 October 20X3 over an estimated period of four years.

The above two fair value adjustments have not been reflected in the individual financial statements of Bee. In the consolidated financial statements, these fair value adjustments will be regarded as temporary differences for the purposes of computing deferred tax. The rate of deferred tax to apply to temporary differences is 20%.

Ayre uses the proportion of net assets method to calculate non-controlling interests in Bee.

Note 2 – Impairment review of goodwill on acquisition of Bee

No impairment of the goodwill on acquisition of Bee was evident when reviews were carried out on 30 September 20X3 and 20X4. On 30 September 20X5, the directors of Ayre concluded that the recoverable amount of the net assets (including the goodwill) of Bee at that date was \$450m. Bee is regarded as a single cash generating unit for the purpose of measuring goodwill impairment.

Note 3 – Ayre's investment in Cee

On 1 October 20X4, Ayre acquired 144 million shares in Cee by means of a cash payment of \$125m. Ayre incurred costs of \$1m associated with this purchase and debited these costs to administrative expenses in its draft statement of profit or loss for the year ended 30 September 20X5. There has been no change in the carrying amount of this investment in the financial statements of Ayre since 1 October 20X4.

On 1 October 20X4, the individual financial statements of Cee showed the following reserves balances:

- Retained earnings \$45m
- Other components of equity \$2m

On 1 October 20X4, the fair values of the net assets of Cee were the same as their carrying amounts with the exception of some land which had a carrying amount of \$100m and a fair value of \$130m. This land continued to be an asset of Cee at 30 September 20X5. The fair value adjustment has not been reflected in the individual financial statements of Cee. In the consolidated financial statements, the fair value adjustment will be regarded as a temporary difference for the purposes of computing deferred tax. The rate of deferred tax to apply to temporary differences is 20%.

There was no impairment of the goodwill arising on acquisition of Cee in the consolidated financial statements at 30 September 20X5.

Ayre uses the proportion of net assets method to calculate non-controlling interests in Cee.

Note 4 – Other investments

Apart from its investments in Bee and Cee, the investments of Ayre included in the statement of financial position at 30 September 20X5 are all financial assets which Ayre measures at fair value through other comprehensive income. These other investments are correctly measured in accordance with IFRS 9 *Financial Instruments*.

Note 5 – Intra-group sale of inventories

The inventories of Ayre and Cee at 30 September 20X5 included components purchased from Bee in the last three months of the financial year at a cost of \$20m to Ayre and \$16m to Cee. Bee supplied these goods to both Ayre and Cee at a mark-up of 25% on the cost to Bee.

QUESTIONS

Note 6 – Trade receivables and payables

Group policy is to clear intra-group balances on a given date prior to each year end. All group companies had complied with this policy at 30 September 20X5, so at that date there were no outstanding intra-group balances.

Note 7 – Provision

On 30 September 20X5, Ayre finalised the construction of an energy generating facility. The facility has an expected useful economic life of 25 years and Ayre has a legal requirement to decommission the facility at the end of its estimated useful life. The directors of Ayre estimated the costs of this decommissioning to be \$34m – based on prices prevailing at the end of the 25 year useful life. At an appropriate discount rate the present value of the cost of decommissioning the facility is \$10m. The directors of Ayre made a provision of \$34m and charged this amount as an operating cost in the financial statements of Ayre for the year ended 30 September 20X5.

Note 8 – Long-term borrowings

On 1 October 20X4, Ayre issued 40 million \$1 bonds at par. The cost of issuing the bonds was \$1m and this cost was charged as a finance cost for the year ended 30 September 20X5. No interest is payable on the bonds but they are redeemable at a large premium which makes their effective finance cost 8% per annum. The bonds are included at a carrying amount of \$40m in the statement of financial position of Ayre at 30 September 20X5.

Required

- (a) Prepare the consolidated statement of financial position of Ayre at 30 September 20X5. You need only consider the deferred tax implications of any adjustments you make where the question specifically refers to deferred tax. **(36 marks)**

On 15 November 20X5, Ayre purchased shares in Theta which gave Ayre a 45% shareholding in Theta. On the same date, Ayre purchased an option which gave Ayre the right to acquire an additional 10% of the shares in Theta from the existing shareholders. This option is exercisable at any time between 15 November 20X5 and 30 September 20X7 at a price which makes it highly likely the option will be exercised during that period. The directors of Ayre are unsure how to treat Theta in the consolidated financial statements for the year ended 30 September 20X6.

Required

- (b) Advise the directors of Ayre on the appropriate treatment of Theta in the consolidated financial statements for the year ended 30 September 20X6 prior to any exercising of the option. **(4 marks)**

(Total = 40 marks)

59 Alpha Group 8 (2011 Pilot Exam) (amended)

78 mins

The statements of profit or loss and comprehensive income of Alpha, Beta and Gamma for the year ended 31 March 20Y1 are given below:

	Alpha \$'000	Beta \$'000	Gamma \$'000
Revenue	240,000	150,000	120,000
Cost of sales	(190,000)	(110,000)	(100,000)
Gross profit	50,000	40,000	20,000
Distribution costs	(7,000)	(6,000)	(6,000)
Administrative expenses	(10,000)	(7,000)	(8,000)
Profit from operations	33,000	27,000	6,000
Investment income	18,000	Nil	Nil
Finance cost	(8,000)	(4,000)	(7,200)
Profit before tax	43,000	23,000	(1,200)
Income tax expense	(12,800)	(7,500)	Nil
Net profit for the year	30,200	15,500	(1,200)
Other comprehensive income (net of tax)	6,000	2,000	1,500
Total comprehensive income for the year	36,200	17,500	300



Note 1 – Beta

On 1 April 20X5 Alpha incorporated Beta and subscribed for 100% of its equity shares at par. Alpha also made a loan of \$40m to Beta at a fixed annual interest rate of 5%. The loan is due for repayment on 30 September 20Y5. On 31 December 20Y0 Alpha sold its holding in Beta for \$65m. At 1 April 20X0 Beta's net assets amounted to \$45m.

Note 2 – Purchase of shares in Gamma

On 1 July 20Y0 Alpha purchased 80% of the equity shares of Gamma. The purchase consideration was as follows:

- Alpha issued 30 million shares to the shareholders of Gamma. The market price of an Alpha share on 1 July 20Y0 was \$2.00.
- Alpha agreed to make an additional payment of \$25m to the shareholders of Gamma on 30 June 20Y2. This payment was contingent on the post-acquisition profits of Gamma reaching a specified level in the two-year period ending on 30 June 20Y2. The directors of Alpha assessed that the fair value of this contingent consideration was \$15m on 1 July 20Y0. They reassessed the fair value of the contingent consideration at \$9m on 31 March 20Y1. The decline in the fair value of the contingent consideration was caused by the losses of Gamma in the post-acquisition period.
- Alpha incurred incremental legal and professional fees of \$1m in connection with the acquisition of Gamma and debited these costs to the cost of investment in Gamma. \$400,000 of this amount related to the costs of issuing the Alpha shares.

Note 3 – Fair value exercise

A set of individual financial statements prepared for Gamma at 1 July 20Y0 showed that its net assets at that date were \$80m. The directors of Alpha carried out a fair value exercise on the net assets of Gamma on that date. The fair values of the net assets of Gamma were the same as their carrying amounts with the exception of:

- Plant and equipment that had a carrying amount of \$60m and a fair value of \$66m. The estimated remaining useful life of this plant and equipment was three years at 1 July 20Y0. Depreciation of plant and equipment is charged to cost of sales.
- A loan of \$32m that carried a fixed annual rate of interest of 10% and was repayable on 30 June 20Y5. Because annual market rates of interest were 8% at 1 July 20Y0 the fair value of this loan at that date was \$34.55m.

Note 4 – Basis of measurement of non-controlling interests

It is the policy of Alpha to measure non-controlling interests based on their fair value at the date of acquisition. The estimated fair value of the non-controlling interest in Gamma at 1 July 20Y0 was \$15m.

Note 5 – Impairment review

On 31 March 20Y1 the directors of Alpha reviewed the goodwill on acquisition of Gamma for impairment. They measured the recoverable amount of Gamma (as a single cash-generating unit) at \$86m at that date. All impairments are charged to cost of sales.

Note 6 – Intra-group sales

Alpha supplies products used by Gamma. Sales of the products to Gamma during the year ended 31 March 20Y1 were as follows (all sales were made at a profit margin of 20%):

- Sales to Gamma (all since 1 July 20Y0) \$10m

At 31 March 20Y1 and 31 March 20Y0 the inventory of Gamma included the following amounts in respect of goods purchased from Alpha.

	<i>Amount in inventory at</i>	
	<i>31 March 20Y1</i>	<i>31 March 20Y0</i>
	\$'000	\$'000
Gamma	2,500	Nil

QUESTIONS

Note 7 – Dividend payments

On 1 October 20Y0 Alpha and Beta paid dividends to their equity shareholders of \$20m and \$10m respectively.

Note 8 – Sale of investment

On 1 August 20X6 Alpha purchased an equity investment and made an irrevocable election to measure this financial asset at fair value through other comprehensive income. On 31 March 20Y0 the equity investment had a fair value of \$7m and was included at this amount in Alpha's statement of financial position. On 1 April 20Y0 Alpha disposed of this investment for net proceeds of \$7m. The cumulative gain of \$500,000 previously recognised in other comprehensive income has been reclassified and included within investment income.

Note 9 – Alterations to leased asset

On 1 April 20Y0 Alpha completed alterations to a property that was being leased with a remaining lease term of ten years from 1 April 20Y0. The cost of the alterations was \$5m. Under the terms of the lease the property must be returned to the lessor in its original condition on 31 March 20Z0. The costs of restoring the property on 31 March 20Z0 were estimated at \$3.5m (at 31 March 20Z0 prices). An appropriately adjusted discount rate appropriate to this transaction is 6% per annum. When preparing the financial statements for the year ended 31 March 20Y1 the directors made a provision of \$350,000 ($\$3.5\text{m} \times 1/10$) and charged this amount as an administrative expense. When using a discount rate of 6% the present value of \$1 payable in ten years is 56 cents.

Note 10 – Foreign currency loan

On 1 April 20Y0 Alpha borrowed 20 million francs from a foreign bank when the exchange rate was \$1 = 4 francs. The loan attracts no interest but 26.62 million francs is repayable on 31 March 20Y3. This represents an effective interest rate of 10% per annum. The average and closing exchange rate for the year ended 31 March 20Y1 was \$1 = 5 francs. Alpha initially recorded the loan in its financial statements at \$5m and has made no further entries regarding this loan.

Note 11 – Development expenditure

On 1 January 20Y0 Alpha began a project to develop a more cost-effective method of disposing of its waste products. Alpha incurred costs of \$2m on this project from 1 January 20Y0 to 30 April 20Y0. On 1 May 20Y0 the project was formally assessed as being technically feasible, commercially viable, and capable of generating economic benefits over a five year period. Alpha incurred further expenditure of \$4m on developing the process between 1 May 20Y0 and 31 December 20Y0. They began to benefit from the process from 1 January 20Y1. Alpha has charged all the costs of developing the process to cost of sales.

Note 12 – Convertible loan

On 1 April 20Y0 Alpha issued 100 million \$1 bonds at par. The bonds carry no interest entitlement but are redeemable on 31 March 20Y5 at \$1.16 per bond. The bond-holders have the option to convert the bonds into equity shares on 31 March 20Y5. On 1 April 20Y0 investors would have required an annual return of 5% on bond investments that were not convertible. The present value of the bond assuming no conversion rights was \$90.48m. Alpha has not charged any finance cost in respect of this bond.

Required

Prepare the consolidated statement of profit or loss and other comprehensive income for Alpha for the year ended 31 March 20Y1. Ignore deferred tax. (40 marks)

60 Alpha, Beta, Gamma (6/11) (amended)**78 mins**

The statements of profit or loss and other comprehensive income and summarised statements of changes in equity of Alpha, Beta and Gamma for the year ended 31 March 20X8 are given below:

STATEMENTS OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME

	<i>Alpha</i>	<i>Beta</i>	<i>Gamma</i>
	\$'000	\$'000	\$'000
Revenue	470,000	434,000	226,000
Cost of sales	(256,000)	(218,000)	(176,000)
Gross profit	214,000	216,000	50,000
Distribution costs	(18,000)	(17,000)	(15,000)
Administrative expenses	(19,000)	(16,000)	(17,000)
Investment income (Note 5)	37,300	Nil	Nil
Finance cost (Note 6)	(68,000)	(65,000)	(44,000)
Profit/(loss) before tax	146,300	118,000	(26,000)
Income tax expense	(41,000)	(33,000)	Nil
Profit/(loss) for the year	<u>105,300</u>	<u>85,000</u>	<u>(26,000)</u>

SUMMARISED STATEMENTS OF CHANGES IN EQUITY

	<i>Alpha</i>	<i>Beta</i>	<i>Gamma</i>
Balance at 1 April 20X7	540,000	390,000	192,000
Comprehensive income for the year	105,300	85,000	(26,000)
Dividends paid on 31 December 20X7	(52,000)	(40,000)	Nil
Balance at 31 March 20X8	<u>593,300</u>	<u>435,000</u>	<u>166,000</u>

Note 1 – Purchase of shares in Beta

On 1 October 20X6 Alpha purchased 75 million of the 100 million equity shares in Beta. Details of the share purchase were as follows:

- (i) Alpha issued two new equity shares for every three shares acquired in Beta. On 1 October 20X6 the market value of an Alpha share was \$6 and the market value of a Beta share was \$3.20.
- (ii) Alpha agreed to make an additional cash payment of \$1 for every share acquired in Beta to be paid on 30 September 20X8. This payment is contingent on the profits of Beta exceeding a cumulative target in the two-year period ending 30 September 20X8. The fair value of this contingent payment was \$55m on 1 October 20X6. The fair value had risen to \$58m by 31 March 20X7 and to \$64m by 31 March 20X8. The directors of Alpha correctly accounted for this contingent consideration in its financial statements for the year ended 31 March 20X7 but no changes have been made to the carrying amount of the contingent consideration since 31 March 20X7.
- (iii) Alpha incurred legal and professional costs of \$5m connected with the acquisition; \$2.4m of these costs related to the cost of issuing shares. Alpha correctly accounted for these acquisition costs in its financial statements for the year ended 31 March 20X7.

Alpha decided to value the non-controlling interest in Beta at the date of acquisition at fair value in its consolidated financial statements. The market value of a Beta share at that date was used to calculate the fair value of the non-controlling interest.

The equity of Beta as shown in its own financial statements at 1 October 20X6 was \$300m. At that date the property, plant and equipment (PPE) of Beta had a carrying amount of \$240m and a fair value of \$280m.

The estimated future useful life of the PPE of Beta was four years from 1 October 20X6. No disposals of PPE occurred between 1 October 20X6 and 31 March 20X7.

On 1 October 20X6 the directors estimated that the internally generated brand name of Beta had a fair value of \$30m and a future useful life of 30 years.

All depreciation and amortisation is charged on a monthly basis and presented in cost of sales.

QUESTIONS

Note 2 – Impairment review

On 31 March 20X7 and 31 March 20X8 the goodwill on consolidation of Beta was reviewed for impairment. No impairment of the goodwill was necessary as a result of the review on 31 March 20X7. Beta is regarded as a single cash generating unit for impairment purposes and at 31 March 20X8 its recoverable amount was estimated as \$550m. Any impairment of goodwill is charged to cost of sales.

Note 3 – Purchase of shares in Gamma

On 1 October 20X7 Alpha purchased 40% of the equity shares of Gamma for \$75m in cash. This purchase allowed Alpha to exercise a significant influence over Gamma. No material differences between the market value and the carrying amount of the net assets of Gamma were apparent at the date of the share purchase. On 31 March 20X8 an impairment review was conducted resulting in an impairment required of \$1.8m.

Note 4 – Inter-company sales

Beta supplies products to Alpha and Gamma. Sales of the products to Alpha and Gamma during the year ended 31 March 20X8 were as follows (all sales were made at a mark-up of 33% on cost):

- Sales to Alpha \$18m
- Sales to Gamma \$12m

At 31 March 20X8 and 31 March 20X7 the inventories of Alpha and Gamma included the following amounts in respect of goods purchased from Beta.

	Amount in inventory at	
	31 March 20X8	31 March 20X7
	\$'000	\$'000
Alpha	3,600	2,100
Gamma	2,700	Nil

Note 5 – Equity investments

At 1 April 20X7 Alpha had two equity investments. Alpha made an irrevocable election to measure these at fair value through other comprehensive income in accordance with IFRS 9 *Financial Instruments*, at the date of acquisition.

Name	Original cost	Fair value at 31 March	
		20X7	20X8
	\$'000	\$'000	\$'000
Delta	12,000	15,000	n/a
Epsilon	11,000	14,000	15,400

On 31 January 20X8 Alpha disposed of its investment in Delta for \$19.5m and showed a profit on sale of \$4.5m (\$19.5m – \$15m) as part of investment income. Apart from recording the receipt of dividend income no other entries have been made in the financial statements for the year ended 31 March 20X8 regarding the investment in Epsilon. Both investments had been correctly treated in the financial statements for the year ended 31 March 20X7.

Note 6 – Convertible notes

On 1 April 20X7 Alpha issued 300 million loan notes of \$1 per note at par. The loan notes entitled the holders to an interest payment of 5 cents per note, payable annually in arrears. The loan notes are repayable at par on 31 March in five years' time. As an alternative to repayment the holders can elect to convert the notes into equity shares in Alpha. On 1 April 20X7 investors in non-convertible notes would expect an annual return of 8%. You are given the following discount factors:

Discount rate	Present value of \$1 payable	
	At the end of year 5	Cumulatively at the end of years 1–5
5%	78.4 cents	\$4.33
8%	68.1 cents	\$3.99



On 1 April 20X7 the directors of Alpha recorded a loan liability of \$300m and in the year ended 31 March 20X8 a finance cost of \$15m (300m × 5 cents) in respect of these notes.

Note 7 – Environmental damage

During the year ended 31 March 20X8 Alpha began production at three newly acquired factories. The normal production process at each factory results in environmental damage. Alpha has a policy of only rectifying such damage when legally required to do so. Details of the damage caused at the three sites up to and including 31 March 20X8 are as follows:

Factory	Damage caused by 31 March 20X8 \$'000	Clean-up legislation in place at 31 March 20X8?
A	3,000	Yes
B	1,000	No
C	2,000	No but legislation passed since year end with retrospective effect

No provision for environmental damage has been made in the financial statements. Any appropriate provision should be reported as part of cost of sales.

Required

- Prepare the consolidated statement of profit or loss and other comprehensive income for Alpha for the year ended 31 March 20X8. (33 marks)
- Prepare the summarised consolidated statement of changes in equity for Alpha for the year ended 31 March 20X8. Your summarised statement should include a column for the non-controlling interest. (7 marks)

Note. Ignore deferred tax.

(Total = 40 marks)

61 Alpha (12/12) (amended)

78 mins

The statements of profit or loss and other comprehensive income of Alpha, Beta and Gamma for the year ended 30 September 20X2 are given below:

STATEMENTS OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME

	Alpha \$'000	Beta \$'000	Gamma \$'000
Revenue	240,000	150,000	120,000
Cost of sales	(190,000)	(110,000)	(70,000)
Gross profit	50,000	40,000	50,000
Distribution costs	(7,000)	(6,000)	(8,000)
Administrative expenses	(10,000)	(7,000)	(8,000)
Profit from operations	33,000	27,000	34,000
Investment income	15,300	Nil	Nil
Finance cost	(8,000)	(4,900)	(7,300)
Profit before tax	40,300	22,100	26,700
Income tax expense	(10,100)	(6,000)	(6,700)
Net profit for the period	30,200	16,100	20,000
Other comprehensive income	4,000	Nil	Nil
Total comprehensive income	34,200	16,100	20,000

Note 1 – Purchase of shares in Beta

On 1 October 20X1, Alpha purchased 80% of the equity shares of Beta. The purchase consideration was as follows:

- Alpha issued 32 million shares to the shareholders of Beta. The market price of an Alpha share on 1 October 20X1 was \$2.50.

- Alpha agreed to make an additional payment of \$30m to the shareholders of Beta on 30 September 20X3. This payment was contingent on the post-acquisition profits of Beta reaching a specified level in the two-year period ending on 30 September 20X3. The directors of Alpha assessed that the fair value of this contingent consideration was \$20m on 1 October 20X1 and debited \$20m to the cost of investment in Beta. They reassessed the fair value of the contingent consideration at \$22m on 30 September 20X2. The increase in the fair value of the contingent consideration was caused by the better than expected performance of Beta in the post-acquisition period. The directors of Alpha made no change to the carrying amount of the cost of investment in Beta as a result of this reassessment.
- Alpha incurred incremental legal and professional fees of \$1.5m in connection with the acquisition of Beta and debited these costs to the cost of investment in Beta. \$500,000 of this amount related to the costs of issuing the Alpha shares.

Note 2 – Fair value exercise

The directors of Alpha carried out a fair value exercise on the net assets of Beta on 1 October 20X1. On 1 October 20X1, the equity of Beta as shown in its own financial statements was \$88m. The fair values of the net assets of Beta were the same as their carrying amounts with the exception of:

- Plant and equipment that had a carrying amount of \$80m and a fair value of \$84m. The estimated remaining useful life of this plant and equipment was two years at 1 October 20X1. Depreciation of plant and equipment is charged to cost of sales.
- An intangible asset that had a fair value of \$6m but was not recognised by Beta because it was internally developed. The useful life of this asset was estimated at 18 months from 1 October 20X1. Amortisation of intangible assets is charged to cost of sales.
- Inventory that had a carrying amount of \$3m and a fair value of \$3.2m. All this inventory was sold in the year ended 30 September 20X2.
- The fair value adjustments are temporary differences that attract deferred tax at a rate of 25%.

Note 3 – Basis of measurement of non-controlling interests

It is the policy of Alpha to measure non-controlling interests based on their fair value at the date of acquisition. The estimated fair value of the non-controlling interest in Beta at 1 October 20X1 was \$20m.

Note 4 – Other information regarding Beta

- On 1 October 20X1, Alpha made a loan of \$40m to Beta at a fixed annual interest rate of 5%. Both Alpha and Beta have correctly accounted for the interest on this loan in their individual statements of profit or loss and other comprehensive income.
- On 31 March 20X2, Beta paid a dividend of \$10m to its equity shareholders.

Note 5 – Impairment review

On 30 September 20X2, the directors of Alpha reviewed the goodwill on acquisition of Beta for impairment. They measured the recoverable amount of Beta (as a single cash-generating unit) at \$118m at that date. Impairment of goodwill is charged to cost of sales.

Note 6 – Purchase of shares in Gamma

- On 1 January 20X2, Alpha and another investor both purchased 50% of the equity capital of Gamma for a cash payment of \$50m. These investments enabled the two investors to jointly control Gamma.
- On 31 March 20X2, Gamma paid a dividend of \$10m to its equity shareholders.
- The recoverable amount of the investment in Gamma by Alpha was estimated at \$50m on 30 September 20X2.
- Ignore the deferred tax implications of the investment in Gamma.

Note 7 – Inter-company sales

Alpha supplies products used by Beta and Gamma. Sales of the products to Beta and Gamma during the year ended 30 September 20X2 were as follows (all sales were made at a profit margin of 20%):

- Sales to Beta \$25m
- Sales to Gamma (all since 1 January 20X2) \$12m

At 30 September 20X2, the inventories of Beta and Gamma included the following amounts in respect of goods purchased from Alpha. Ignore the deferred tax implications of the inter-company sales to Beta and Gamma.

	\$'000
Beta	5,000
Gamma	4,000

Note 8 – Share based payments

On 1 October 20X1, Alpha granted 1,000 senior employees 2,500 share options each, provided they remained as employees for the two years ending 30 September 20X3. On 1 October 20X1, the fair value of one share option was \$5 and this had increased to \$5.40 by 30 September 20X2. On 1 October 20X1, the directors estimated that 950 employees would qualify for these options. At 30 September 20X2, this estimate was 960 employees. Ignore the deferred tax implications of this transaction.

Note 9 – Other comprehensive income of Alpha

On 1 September 20X1, Alpha entered into a contract to sell €60m for \$85m. This contract was to hedge against an expected sales receipt from a customer on 31 January 20X2 that was denominated in €. On 30 September 20X1, the contract was a financial asset with a fair value of \$1m. Alpha designated the contract as a cash-flow hedge of the expected future sales in € and credited \$1m to other comprehensive income in the year ended 30 September 20X1. On 31 January 20X2, the sales in € were made to the customer and the customer paid for the goods on that date. On 31 January 20X2, the fair value of the contract to sell €60m for \$85m was \$5m. Therefore Alpha credited a further \$4m to other comprehensive income and recorded the sales revenue at €60m, translated at the spot rate of exchange on that date.

Note 10 – Investment by Alpha in Zeta

On 1 October 20X1, Alpha purchased 100,000 equity shares in Zeta for \$10 per share. The investment did not give Alpha control or significant influence over Zeta and was designated by Alpha as fair value through other comprehensive income. Alpha incurred transaction costs of \$50,000 which it recorded as part of its finance costs. During the period Alpha received a dividend of \$2 per share from Zeta and at 30 September 20X2 the fair value of a Zeta share was \$11. Alpha recorded both the dividend and the increase in fair value of its holding as investment income. Ignore the deferred tax implications of this transaction.

Required

Prepare the consolidated statement of profit or loss and other comprehensive income for Alpha for the year ended 30 September 20X2. (40 marks)



62 Alpha Group (6/14) (amended)

78 mins

Alpha holds investments in two other entities, Beta and Gamma. The statements of profit or loss and other comprehensive income of the three entities for the year ended 31 March 20X4 were as follows:

STATEMENTS OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME

	<i>Alpha</i> \$'000	<i>Beta</i> \$'000	<i>Gamma</i> \$'000
Revenue (Note 4)	420,000	335,000	292,000
Cost of sales (Note 4)	<u>(240,000)</u>	<u>(192,000)</u>	<u>(168,000)</u>
Gross profit	180,000	143,000	124,000
Distribution costs	(20,000)	(16,000)	(14,000)
Administrative expenses	(40,000)	(32,000)	(28,000)
Contributions to retirement benefit plan (Note 5)	(5,000)	Nil	Nil
Finance costs	(20,000)	(15,000)	(12,000)
Investment income (Note 6)	<u>33,000</u>	<u>Nil</u>	<u>Nil</u>
Profit before tax	128,000	80,000	70,000
Income tax expense	(32,000)	(20,000)	(16,000)
Profit for the year	96,000	60,000	54,000
Other comprehensive income:			
Items that will not be reclassified to profit or loss			
Gain on property revaluation (Note 7)	<u>25,000</u>	<u>Nil</u>	<u>12,000</u>
Total comprehensive income for the year	<u>121,000</u>	<u>60,000</u>	<u>66,000</u>

Notes to the statements

Note 1 – Acquisition of Beta

On 1 April 20W5, Alpha purchased 80% of the equity shares of Beta and gained control of Beta. Goodwill arising on the acquisition of Beta totalled \$80m. At 1 April 20W5, Beta had three cash-generating units and the goodwill on acquisition was allocated to the three units as follows:

- Unit 1 – 40%
- Unit 2 – 35%
- Unit 3 – 25%

No impairment of this goodwill had occurred in the years ended 31 March 20W6 to 20X3 inclusive. However, in the year ended 31 March 20X4, despite Beta making a profit overall, Beta suffered challenging trading conditions. Therefore the directors of Alpha carried out an impairment review on the goodwill at 31 March 20X4 and obtained the following results:

<i>Unit</i>	<i>Carrying amount of net assets (excluding goodwill) at 31 March 20X4</i> \$'000	<i>Recoverable amount at 31 March 20X4</i> \$'000
1	215,000	255,000
2	185,000	220,000
3	130,000	140,000
Total	<u>530,000</u>	<u>615,000</u>

None of the assets or liabilities of Beta which Alpha identified on 1 April 20W5 remained in the statement of financial position of Beta at 31 March 20X3 or 20X4. Any impairment of goodwill should be charged to cost of sales.

Alpha measures all non-controlling interests based on their fair values at the date of acquisition of the relevant subsidiary.

Note 2 – Acquisition of Gamma

On 1 July 20X3, Alpha acquired 40% of the equity capital of Gamma. The purchase consideration comprised the following:

- An issue of equity shares.
- A cash payment of \$65.34m due on 30 June 20X5. On 1 July 20X3, Alpha's borrowing rate was 10% per annum. No entry has yet been made in Alpha's financial statements regarding this future cash payment.

The other 60% of Gamma's shares are held by a wide variety of investors, none of whom owns more than 0.5% individually. None of the other shareholders has any arrangements to consult any of the others or make collective decisions. Since 1 July 20X3, Alpha has actively participated in establishing the operating and financial policies of Gamma.

When reviewing the net assets of Gamma as at 1 July 20X3, the directors of Alpha ascertained the following:

- The properties of Gamma had been revalued at 31 March 20X3 and there was no significant difference between their carrying amounts at 1 July 20X3 and their fair values at 31 March 20X3.
- The plant and equipment of Gamma had a carrying amount at 1 July 20X3 of \$70m and a fair value at that date of \$78m. The estimated future useful life of the property, plant and equipment at 1 July 20X3 was four years, with zero residual value.
- On 1 July 20X3, Gamma was in the process of completing the development of a new method of production which will significantly reduce wastage. As at 1 July 20X3, Gamma had recognised an intangible asset of \$10m in its financial statements in respect of this development. The directors of Alpha believed that, as at 1 July 20X3, the process had a fair value of \$22m and that the process will produce economic benefits evenly for ten years from 1 January 20X4.
- On 1 July 20X3, Gamma had a contingent liability which it did not recognise in its own financial statements. This contingent liability still existed, and was still unrecognised by Gamma, at 31 March 20X4. As at 1 July 20X3, the directors of Alpha believed that the contingent liability had a fair value of \$16m. On 31 March 20X4, they reassessed its fair value at \$12m. The reassessment was due to a change in circumstances after 1 July 20X3.

The directors of Alpha believe that the facts described in this note mean that Gamma has been a subsidiary of Alpha since 1 July 20X3 and wish to consolidate it. Based on the assumption that Gamma is consolidated, no impairment of the goodwill on consolidation is required at 31 March 20X4. The profit of Gamma for the year ended 31 March 20X4 accrued evenly over the year. However, as noted above, all of the other comprehensive income of Gamma arose after 1 July 20X3. Any consolidation adjustments which are necessary as a result of the information given in this note should be regarded as temporary differences for the purpose of computing deferred taxation. The rate of corporate income tax in the jurisdiction in which all three entities are located is 25%.

Note 3 – Presentation of depreciation and amortisation

All depreciation and amortisation charges should be presented as part of cost of sales.

Note 4 – Trading between Alpha and Beta

- 1 Alpha supplies a component to Beta which is used by Beta in its production process. Alpha marks up its cost of production by one-third in arriving at the selling price. In the year ended 31 March 20X4, the revenues of Alpha included \$30m in respect of the sale of these components. On 31 March 20X4, the inventories of Beta included \$6m. On 31 March 20X3, the inventories of Beta included \$4.4m in respect of identical unsold components purchased from Alpha at the same mark up on cost.

QUESTIONS

- 2 During the year ended 31 March 20X3, Alpha manufactured a machine which was to be used by Beta from 1 April 20X3. The costs of manufacture totalled \$12m. On 1 April 20X3, Alpha transferred the machine to Beta for an invoiced price of \$16m, including relevant amounts in revenue and cost of sales. Beta included the machine in its property, plant and equipment and depreciated the machine over its estimated useful life of four years, with no residual value.

Any consolidation adjustments which are necessary as a result of the information given in this note should be regarded as temporary differences for the purpose of computing deferred taxation.

Note 5 – Defined benefit retirement benefits plan

Certain senior executives of Alpha belong to a defined benefit retirement benefits plan. In the financial statements of Alpha, the contributions paid into this plan have been shown as an expense in the statement of profit or loss and other comprehensive income. Relevant information regarding this plan is as follows:

- The pension liability was \$60m at 31 March 20X3. This liability increased to \$68m by 31 March 20X4.
- The pension asset was \$40m at 31 March 20X3. This asset increased to \$46m by 31 March 20X4.
- The current service cost was \$4.5m.
- Alpha's borrowing rate at 31 March 20X4 was 9% per annum. On that date market yields on government bonds were 8% per annum.

The salary costs of the senior executives who belong to this plan are presented in administrative expenses. You should ignore any adjustment to deferred tax as a result of the information included in this note.

Note 6 – Payment of dividends

On 31 December 20X3, Beta paid a dividend of \$30m and Gamma paid a dividend of \$20m. Alpha recognised its share of both dividends in its investment income.

Note 7 – Property revaluations

It is the policy of the Alpha group to measure freehold properties using the fair value model and all freehold properties were revalued on 31 March 20X4. The gains shown in the financial statements of Alpha and Gamma do not take account of the deferred tax implications of the revaluations.

Note 8 – Hedge of future property purchase

On 1 February 20X4, Alpha entered into a firm commitment to purchase a property on 31 May 20X4 for €40m. In order to eliminate the impact of currency fluctuations, on 1 February 20X4 Alpha entered into a contract to purchase €40m for \$48m on 31 May 20X4. This contract had no cost and Alpha did not record it in the financial statements for the year ended 31 March 20X4. On 31 March 20X4, the contract had a fair value of \$3.6m (financial asset). Alpha uses hedge accounting whenever permitted by International Financial Reporting Standards. Where a choice of hedge accounting method exists, Alpha uses cash-flow hedge accounting.

You should ignore any adjustment to deferred tax as a result of the information included in this note.

Required

- (a) Discuss the appropriateness of the directors' view that Gamma became a subsidiary of Alpha on 1 July 20X3. (5 marks)
- (b) Prepare the consolidated statement of profit or loss and other comprehensive income of Alpha for the year ended 31 March 20X4. For this part you should assume that Gamma is a subsidiary of Alpha from 1 July 20X3. (35 marks)

(Total = 40 marks)

63 Aran Group (12/14) (amended)

78 mins

Aran holds investments in two other entities, Merino and Cashmere. The statements of profit or loss and other comprehensive income and summarised statements of changes in equity of the three entities for the year ended 30 September 20X4 were as follows:

STATEMENTS OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME

	<i>Aran</i>	<i>Merino</i>	<i>Cashmere</i>
	\$'000	\$'000	\$'000
Revenue (Note 3)	260,000	200,000	180,000
Cost of sales (Notes 1–3)	(130,000)	(110,000)	(90,000)
Gross profit	130,000	90,000	90,000
Distribution costs	(20,000)	(15,000)	(13,500)
Administrative expenses (Note 4)	(25,000)	(20,000)	(18,000)
Redundancy and reorganisation costs (Note 5)	(14,000)	Nil	Nil
Investment income (Note 6)	12,600	Nil	1,500
Finance costs (Note 7)	(26,000)	(15,000)	(12,000)
Profit before tax	57,600	40,000	48,000
Income tax expense	(14,000)	(10,000)	(12,000)
Profit for the year	43,600	30,000	36,000
Other comprehensive income:			
Items that will not be reclassified to profit or loss			
Gains on financial assets designated at fair value through other comprehensive income (Note 8)	9,000	1,400	Nil
Total comprehensive income	52,600	31,400	36,000

Note 1 – Alpha's investment in Merino

On 1 October 20W1, Aran acquired 75% of the equity shares of Merino. This gave Aran control over Merino. On 1 October 20W1, the net assets of Merino had a fair value of \$80m. None of the assets and liabilities of Merino which existed on 1 October 20W1 were still assets or liabilities of Merino on 30 September 20X3. On 1 October 20W1, Aran measured the non-controlling interest in Merino at its fair value of \$22m. Goodwill on consolidation of \$18m arose on the acquisition of Merino. No impairment of goodwill on the acquisition of Merino has been necessary up to and including 30 September 20X3.

Merino has four operating segments which are also cash generating units (CGUs) for the purposes of impairment reviews. On 1 October 20W1, the goodwill on acquisition of Merino was allocated between these units on the following basis:

- Unit 1 – \$8m
- Unit 2 – \$4m
- Unit 3 – \$3m
- Unit 4 – \$3m

On 30 September 20X4, the carrying amounts of the net assets (excluding goodwill) and recoverable amounts of the four CGUs of Merino were as follows:

	<i>Unit 1</i>	<i>Unit 2</i>	<i>Unit 3</i>	<i>Unit 4</i>	<i>Total</i>
	\$'000	\$'000	\$'000	\$'000	\$'000
Carrying amount	45,000	55,000	30,000	30,000	160,000
Recoverable amount	50,000	65,000	35,000	35,000	185,000

Any impairment of goodwill should be charged to cost of sales.

Note 2 – Aran's investment in Cashmere

On 1 February 20X4, Aran acquired 80% of the 75 million \$1 equity shares of Cashmere for a cash consideration of \$120m. At the date of acquisition, the retained earnings of Cashmere were \$36.3m.

On 1 February 20X4, the fair value of Cashmere's property, plant and equipment exceeded the carrying amounts in the individual financial statements of Cashmere as follows:

- Property excess \$20m (land element of excess \$11m). The estimated remaining useful life of the buildings element of the property at 1 February 20X4 was 25 years.
- Plant and equipment excess \$7.2m. The estimated remaining useful life of the plant and equipment of Cashmere at 1 February 20X4 was three years.

All depreciation of property, plant and equipment is charged to cost of sales.

Aran measured the non-controlling interest in Cashmere on 1 February 20X4 at its fair value of \$28m. There was no impairment of the goodwill arising on the acquisition of Cashmere in the year ended 30 September 20X4. The profit of Cashmere for the year ended 30 September 20X4 accrued evenly over the year.

In August 20X4, the directors of Aran determined that the expenditure required to integrate Cashmere into the group was too high and as such, Aran's investment in Cashmere would be sold. On 30 September 20X4, Aran disposed of its entire shareholding in Cashmere for \$126m in cash. At that date, the fair value of the identifiable net assets of Cashmere was \$145.46m. The disposal of Cashmere did not meet the criteria to be classified as a discontinued operation.

Note 3 – Intra-group trading

Aran supplies a component used by both Merino and Cashmere. Aran applies a mark-up of 25% to cost when computing the intra-group selling price. All of the sales of this component by Aran to Cashmere occurred after the acquisition of Cashmere on 1 February 20X4. Details of the sales of the component, and the holdings of inventory of the component by group entities, are as follows:

	<i>Merino</i>	<i>Cashmere</i>
	\$'000	\$'000
Sales of the component	12,000	5,000
Inventory of component at 30 September 20X4 (at cost to Merino/Cashmere)	2,400	2,000
Inventory of component at 30 September 20X3 (at cost to Merino/Cashmere)	1,800	Nil

Note 4 – Post-employment benefits

The group makes contributions into both defined benefit and defined contribution retirement benefit plans. All the employees of Merino and Cashmere are members of defined contribution plans but many of the employees of Aran are members of a defined benefit plan. The following are relevant details regarding the defined benefit plan:

- Obligation at 30 September 20X4: \$40m (30 September 20X3: \$32m)
- Fair value of plan assets at 30 September 20X4: \$34m (30 September 20X3: \$27m)
- Current service cost for the year ended 30 September 20X4: \$6m
- Contributions paid into the plan by Aran in the year ended 30 September 20X4: \$5.4m
- Benefits paid to retired members: \$2m
- Relevant market yield: 5% per annum throughout the period

Aran has charged the contributions paid into the defined benefit plan in the year ended 30 September 20X4 (\$5.4m) as an administrative expense. Aran has made no other entries in respect of the plan in the statement of profit or loss and other comprehensive income. However, Aran correctly accounted for the defined benefit plan in the financial statements for the year ended 30 September 20X3.

Note 5 – Redundancy and reorganisation costs

The directors of Aran have formulated a plan to reorganise the group. The plan involved some redundancies and some employees changing their roles within the group. As a result of the reorganisation, certain non-current assets of Aran will no longer be required. The final version of the plan was agreed on 31 July 20X4 and made public on 15 August 20X4. The plan was implemented from 1 November 20X4. The total cost of the plan will be borne by Aran. The directors of Aran made a provision, with a corresponding charge to profit or loss, in respect of the plan as follows:

	\$'000
Redundancy costs	10,000
Costs of training staff in new roles	5,500
Expected profit on the sale of surplus non-current assets	<u>(1,500)</u>
	<u>14,000</u>

Note 6 – Investment income

All of the investment income of Aran, including a dividend of \$10m received from Merino on 31 December 20X3, has been correctly recognised in the individual financial statements of Aran. No dividends were paid by Cashmere during the year.

Note 7 – Bond issue

On 1 October 20X3, Aran issued 300 million \$1 bonds at par. The interest payable on the bonds is 5% per annum, payable on 30 September in arrears. The bonds are repayable at par on 30 September 20Y3. Alternatively, the investors have the option to convert the bonds into equity shares in Aran on 30 September 20Y3.

On 1 October 20X3, Aran recognised a financial liability of \$300m in its statement of financial position. On 30 September 20X4, Aran recognised the interest paid on that date as a finance cost in its statement of profit or loss.

On 1 October 20X3, investors would have expected an annual return of 8% on non-convertible bonds. At a discount rate of 8% per annum, the present value of \$1 receivable at the end of year 10 is 46.3 cents and the present value of \$1 receivable at the end of each of years 1 to 10 is \$6.71.

Note 8 – Other comprehensive income

Both Aran and Merino have financial assets (investments in equity instruments) which are appropriately classified as fair value through other comprehensive income as the result of an irrevocable election made when the assets were initially recognised. On 1 February 20X4, the fair value of the financial assets of Merino had not changed from 30 September 20X3.

Note 9 – Forward currency contract

On 15 August 20X4, Aran entered into a commitment to supply a large consignment of components to a foreign customer whose currency is the kroner. The agreed value of the order was 25 million kroner and this amount is expected to be paid by the customer on 30 November 20X4. On 15 August 20X4, Aran entered into a contract to sell 25 million kroner for \$13m on 30 November 20X4. Currency fluctuations in August and September 20X4 were such that on 30 September 20X4 the fair value of this currency contract was \$1.1m (a financial liability). The draft financial statements of Aran do not include any amounts in respect of this currency contract since it has a zero cost. Aran wishes to use cash-flow hedge accounting whenever permitted by International Financial Reporting Standards. The directors of Aran have estimated that the currency contract is a perfectly effective hedge of the commitment to supply the components.

Required

- Using the information in note 2, compute the goodwill arising on the acquisition of Cashmere at 1 February 20X4. (4 marks)
- Prepare the consolidated statement of profit or loss and other comprehensive income of Aran for the year ended at 30 September 20X4. You do not need to consider the deferred tax effects of any adjustments you make. (36 marks)

Note. You should show all workings to the nearest \$'000.

(Total = 40 marks)

64 Abiola (6/16)

78 mins

Abiola's investments include subsidiaries, Busayo and Cuca. The statements of profit or loss and other comprehensive income and summarised statements of changes in equity of the three entities for the year ended 31 March 20X6 were as follows:

STATEMENTS OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME

	<i>Abiola</i> \$'000	<i>Busayo</i> \$'000	<i>Cuca</i> \$'000
<i>Revenue (Notes 3 and 4)</i>	360,000	210,000	190,000
<i>Cost of sales (Notes 1–3)</i>	(240,000)	(110,000)	(100,000)
Gross profit	120,000	100,000	90,000
Distribution costs	(20,000)	(16,000)	(15,000)
Administrative expenses	(30,000)	(19,000)	(18,000)
<i>Investment income (Notes 5 and 6)</i>	19,800	Nil	Nil
Finance costs (Note 7)	(12,000)	(17,000)	(13,000)
Profit before tax	77,800	48,000	44,000
Income tax expense	(15,000)	(12,000)	(11,000)
Profit for the year	62,800	36,000	33,000
<i>Other comprehensive income:</i>			
Items that will not be reclassified to profit or loss			
Gains/(losses) on financial assets designated at fair value through other comprehensive income (Note 5)	Nil	Nil	Nil
<i>Total comprehensive income</i>	<u>62,800</u>	<u>36,000</u>	<u>33,000</u>
Summarised statements of changes in equity			
Balance on 1 April 20X5	200,000	150,000	130,000
Comprehensive income for the year	62,800	36,000	33,000
Dividends paid on 31 December 20X5	(30,000)	(12,000)	(11,000)
Balance on 31 March 20X6	<u>232,800</u>	<u>174,000</u>	<u>152,000</u>

Notes

1 *Abiola's investment in Busayo*

On 1 April 20W4, Abiola acquired 80% of the equity shares of Busayo and gained control of Busayo. Abiola paid \$64 million in cash for these shares.

On 1 April 20W4, the net assets of Busayo had a fair value of \$70 million. None of the assets and liabilities of Busayo which existed on 1 April 20W4 were still assets or liabilities of Busayo on 31 March 20X5.

Abiola measured the non-controlling interest in Busayo using the proportion of net assets method. The resulting goodwill on acquisition of Busayo was correctly recognised in the consolidated financial statements of Abiola. No impairment of goodwill on acquisition of Busayo has been necessary up to and including 31 March 20X5.

On 31 March 20X6, the annual impairment review of the goodwill on acquisition of Busayo indicated that the recoverable amount of the total net assets of Busayo (including the goodwill) at that date was \$180 million. Busayo is regarded as a single cash generating unit for impairment purposes. Any impairment of goodwill should be charged to cost of sales.

2 *Abiola's investment in Cuca*

On 1 October 20X5, Abiola acquired 60% of the equity shares in Cuca and gained control of Cuca. Cuca had 50 million equity shares in issue on 1 October 20X5 and has not issued any new shares since that date. The acquisition was financed as follows:

- Abiola issued two new shares to the former shareholders of Cuca for every three shares Abiola acquired in Cuca. On 1 October 20X5, the fair value of an equity share in Abiola was \$2.80 and the fair value of an equity share in Cuca was \$3.70.

- Abiola agreed to pay a total of \$24.2 million to the former shareholders of Cuca on 30 September 20X7. Abiola's incremental borrowing rate at 1 October 20X5 was 10% per annum.
- Abiola agreed to pay a further amount to the former shareholders of Cuca on 31 December 20X9 if the cumulative profits of Cuca for the four-year period from 1 October 20X5 to 30 September 20X9 exceed \$150 million. On 1 October 20X5, the fair value of this obligation was measured at \$40 million. On 31 March 20X6, this fair value was remeasured at \$42 million.

Abiola has resolved to use the fair value method for measuring the non-controlling interest when recognising the goodwill on acquisition of Cuca. The fair value of an equity share in Cuca on 1 October 20X5 can be used for this purpose. No impairment of the goodwill on acquisition of Cuca is necessary in the consolidated financial statements of Abiola for the year ended 31 March 20X6.

On 1 October 20X5, the fair values of the net assets of Cuca were the same as their carrying amounts in the financial statements of Cuca with the exception of:

- Property – whose fair value exceeded the carrying amount by \$25 million (\$10 million of this excess relates to land). The estimated remaining useful life of the buildings element of the property at 1 October 20X5 was 20 years.
- Plant and equipment – whose fair value exceeded the carrying amount by \$8 million. The estimated remaining useful life of the plant and equipment of Cuca at 1 October 20X5 was four years.

All depreciation of property, plant and equipment is charged to cost of sales. You can assume that the profit of Cuca for the year ended 31 March 20X6 accrued evenly over the year.

3 *Intra-group trading*

Abiola supplies a component used by both Busayo and Cuca. Abiola earns a profit margin of 10% on these supplies. Details of the sales of the component, and the holdings of inventory of the component by group entities, are as follows:

	<i>Busayo</i>	<i>Cuca</i>
	\$'000	\$'000
Sales of the component (for Cuca all sales since 1 October 20X5)	15,000	8,000
Inventory of component at 31 March 20X5 (at cost to Busayo/Cuca)	2,000	Nil
Inventory of component at 31 March 20X6 (at cost to Busayo/Cuca)	3,000	2,800

4 *Revenue of Abiola*

On 1 October 20X5, Abiola sold a large machine to a customer for a total price of \$51.2 million and credited \$51.2 million to revenue. As part of the sales agreement, Abiola agreed to provide annual servicing of the machine for four years from 1 October 20X5 for no additional payment. The normal selling price of this without any annual servicing would have been \$60 million and Abiola would normally charge the customer an annual fee of \$1 million to service the machine. You should ignore the time value of money in respect of this transaction.

5 *Abiola's other investment*

Apart from its investments in Busayo and Cuca, Abiola has one other investment – in entity X. Abiola purchased this equity investment on 1 July 20X5 for \$40 million and designated the investment as fair value through other comprehensive income. In order to protect against a prolonged decline in the fair value of the investment in entity X, Abiola purchased a put option to sell this investment. The cost of the option was \$6 million and the option was regarded as an effective hedge against a prolonged decline in the fair value of the investment in entity X. On 31 March 20X6, the fair value of the equity investment in entity X was \$37 million and the fair value of the put option was \$8.7 million. Apart from recognising the investment in entity X and the put option at cost, Abiola has made no other entries in its draft financial statements. Abiola wishes to use hedge accounting whenever permitted by International Financial Reporting Standards.

QUESTIONS

6 *Investment income*

All of the investment income of Abiola has been correctly recognised in the individual financial statements of Abiola.

7 *Bond issue*

On 1 April 20X5, Abiola issued a convertible zero-coupon bond to a single institutional investor. The bond was issued for total proceeds of \$250 million and will be redeemed or converted into equity shares on 31 March 20Y0. If the investor chooses to redeem the bond on 31 March 20Y0, the investor will receive \$362.32million. The incremental borrowing rate of Abiola on 1 April 20X5 is 10% per annum. The present value of \$1 received in five years at a discount rate of 10% per annum is 62.1 cents.

Required

- (a) Using the information in notes 1 and 2, compute the goodwill arising on the acquisitions of Busayo at 1 April 20W4 and Cuca at 1 October 20X5. (8 marks)
- (b) Prepare the consolidated statement of profit or loss and other comprehensive income of Abiola for the year ended at 31 March 20X6. You do not need to consider the deferred tax effects of any adjustments you make. (25 marks)
- (c) Prepare the summarised consolidated statement of changes in equity of Abiola for the year ended 31 March 20X6, including a column for the non-controlling interest. (7 marks)

Note. You should show all workings to the nearest \$'000.

(Total = 40 marks)

Answers

1 Omega 15 (12/11)

Top tips. This was a detailed question on this area of the syllabus, and goes to show that you must be familiar with the whole syllabus if you are going to pass DipIFR. Part (a) was not easy, but you should have been able to get at least 1–2 marks as long as you explained your points well. Part (b) was actually straightforward if you knew at least the names of the bodies, as their functions are quite self-explanatory after that – the IFRS Advisory Council, for example, provides advice about IFRS. Part (c) was practical and applied, but provided you had done a question in this area you should have been aware, for example, of the requirement to prepare an opening statement of financial position for the comparative financial statements.

Easy marks. Part (b) contained easy marks for just naming the four bodies.

Examining team's comments.

Part (a)

Areas showing good knowledge:

- This was answered reasonably well with many candidates mentioning financing, comparisons and easy consolidation process.

Areas where mistakes were common:

- Some candidates seemed to be expressing the same matter in three slightly different ways rather than raising three distinct benefits.
- Some talked about benefits to investors comparing although the question asked about how the company could benefit.

Part (b)

Areas showing good knowledge:

- Most knew the names of the different bodies but failed to talk sensibly about what they did. Many students simply talked through the process without referring to the bodies at all.

Areas where mistakes were common:

- Some candidates described the components of financial statements rather than the individual components of the standard setting process.

Part (c)

Areas showing good knowledge:

- Most mentioned the comparatives that were needed but then failed to be specific with dates.

Areas where mistakes were common:

- Some candidates merely stated that comparatives were needed. Many talked about the process to restate, which was not what the question asked.
- Many candidates seemed unaware of special disclosures and exemptions.

- (a) Reporting in IFRS could make it easier to raise capital on global markets. Many markets require financial statements to be submitted under local accounting standards or IFRS. Reporting in IFRS would eliminate costs of restatement into local standards.

Moving to IFRS across the group would make the consolidation process easier, as there would be no need to restate financial statements from the local accounting standards of the subsidiaries to the local standards used by Omega, as is currently the case.

IFRS are being used increasingly worldwide, so that knowledge of IFRS would allow us to evaluate potential targets more easily if they use IFRS.

(b) IFRS Foundation

The Foundation is responsible for the standard-setting process as a whole, and seeks to ensure that the standard-setting bodies have appropriate work plans and are financed accordingly.

IASB

The IASB is the IFRS Foundation's independent standard-setting body, which develops and publishes IFRS. In doing this it follows a transparent due process, including the publication of consultation documents such as exposure drafts and discussion papers.

IFRS Advisory Council

The IFRS Advisory Council advises the IASB on a range of issues, such as the appropriateness of its work plan and future priorities. It also advises on single projects with an emphasis on practical and implementation issues.

IFRS Interpretations Committee

The IFRS Interpretations Committee reviews accounting issues that have arisen (or could arise) in the context of IFRS, and provides authoritative guidance on them.

- (c) The financial statements for the year ended 30 September 20X2 will include comparatives, which must also be prepared using IFRS. Therefore, an IFRS statement of financial position must be prepared for 1 October 20X0 (the opening position for the comparatives); for 30 September 20X1 (for the comparatives); and for 30 September 20X2. A comparative statement of profit or loss and other comprehensive income will also need to be prepared.

All of these financial statements should be prepared using the same IFRS as the first IFRS statement of financial position, those in issue on 30 September 20X2.

A reconciliation must be provided between the amounts now disclosed as comparatives under IFRS, and their equivalents under local accounting standards. This will include equity as at 1 October 20X0 and 30 September 20X1, and comprehensive income for the year ended 30 September 20X1.

2 Users

The IASB's *Conceptual Framework for Financial Reporting* tries to provide a structure for corporate reporting by identifying users and their needs. As the statement suggests the IASB identifies a number of different users from shareholders, including creditors, government and employees. The IASB also identifies that these users do have differing needs but, contrary to the suggestion in the question, they do realise that it is impossible to satisfy the specific needs of all potential users and so they attempt to identify common factors which unite all of the parties. The information which they identify as being common to all user groups is that pertaining to the position, performance and adaptability of an entity.

Whether this approach to standard setting will lead to bigger and more complex sets of accounts is certainly an issue which needs to be addressed. When developing standards the IASB considers what makes financial information relevant. It has been decided that the ability to predict future performance is an essential need of most user groups and therefore the additional cost of preparation can be justified. As long as this test is applied it should ensure no irrelevant information is included.

The third point addressed in the question is whether the IASB has been too wide in defining user groups. As mentioned above, because different users have common needs, this issue is rather redundant. However one could also argue that to suggest that the only important group is the current shareholders is naive when considering public companies. The financial statements can be used to attract new investors which benefits the existing shareholders.

The last point deals with the level at which information should be pitched in order to be of maximum benefit to the user. Obviously users are at widely differing levels of financial competence and awareness and, as a result, the financial statements can never be ideal for everyone. What the *Conceptual Framework* argues is that the information presented and the treatments adopted must satisfy the expectations of an educated reader and adequately reflect

the underlying complexity of the transactions and position it is reporting on. The argument is that the less financially-aware user can obtain the key information via a financial adviser. Some countries have provisions requiring the publication of summary financial statements for those shareholders not wishing to receive full accounts. This provision also leads to cost savings as far as the shareholders are concerned.

In conclusion although the question addresses issues of importance in determining the form and content of financial statements, they are all issues that have been considered by the IASB in the *Conceptual Framework*. The conclusion of the IASB is that by grouping users and their needs and pitching the level of information at a reasonably high level then, although not satisfying everyone, the maximum number of users benefits from financial statements.

3 Mocca

Marking scheme

	Marks
(a) Reven does not obtain control of the plant, because the repurchase option means that it is limited in its ability to use and obtain benefit from the plant.	1
As control has not been transferred , Mocca must account for the transaction as a financing arrangement , because the exercise price is above the original selling price. Mocca must continue to recognise the plant and recognise the cash received as a financial liability. The difference of \$50,000 is recognised as interest expense.	1 + 1
If, on 31 March 20X2, the option lapses unexercised, Reven will then obtain control of the plant. In this case, Mocca must will derecognise the plant and recognise revenue of \$550,000 (the \$500,000 already received plus the \$50,000 charged to interest).	1 + 1
	<u>5</u>
(b) (i) Revenue recognition is an important issue in financial reporting and it is generally accepted that revenue is earned when goods have been accepted by the customer or services have been delivered . At that stage the performance obligation has been satisfied and revenue is said to have been realised. However, if this were applied to contracts where performance obligations are satisfied over time, the effect would not necessarily be to give a faithful representation.	1 + 1
As a contract where performance obligations are satisfied over time can span several accounting periods, if no revenue were recognised until the end of the contract, this would certainly be prudent but would not be in accordance with the accruals concept . The financial statements would show all of the profit in the final period, when in fact some of it had been earned in prior periods. This is remedied by recognising attributable profit as the performance obligations are satisfied, as long as ultimate profitability is expected. Any foreseeable loss is recognised immediately.	1 + 1
The time value of money could also be an issue in a contract where performance obligations are satisfied over time, for example if there is a long delay between when an entity satisfies a performance obligation and when the customer is due to pay the promised consideration.	1
	<u>5</u>
(ii) <i>Profit or loss amounts</i>	
	\$'000
Revenue (8,125 – 3,500)	4,625
Cost of sales ((9,500 (W1) × 65%) – 2,660)	(3,515)
Profit (1,950 (W2) – 840)	<u>1,110</u>
	3
	1½

		Marks
<i>Statement of financial position amounts</i>		
	\$'000	
<i>Non-current assets</i>		
Plant (8,000 – 2,500 (W1))	5,500	1½
<i>Current assets</i>		
Trade receivables (8,125 – 7,725)	400	1
Contract asset (see below)	1,125	1
<i>Contract asset</i>		
	\$'000	
Costs to date (4,800 + 2,500)	7,300	1
Profit to date (W2)	1,950	½
Less amounts invoiced	(8,125)	½
Contract asset	<u>1,125</u>	<u>10</u>
		<u>20</u>

Workings

1	<i>Total contract profit</i>		
		\$'000	\$'000
	Total contract revenue		12,500
	Costs to date	4,800	
	Further costs to complete (5,500 – 4,800)	700	
	Plant depreciation to date (8,000 × 15/48)	2,500	
	Remaining depreciation (8,000 × 9/48)	<u>1,500</u>	
	Total expected costs		(9,500)
	Total expected profit on contract		<u>3,000</u>
2	<i>Profit to date</i>		
	% work completed = 8,125/12,500 = 65%		
	Profit to date = 3,000 × 65% = 1,950		

4 Delta (12/14)

Top tips. This is another typical question requiring you to explain three different issues. Part (a) featured a contract with two different performance obligations (IFRS 15). This part carries 9 marks, which should have told you that the examining team were expecting a reasonable amount of detail.

Part (b) tested your knowledge of two standards: IAS 16 and IAS 37.

Part (c) featured a provision and you should have found this very straightforward.

Easy marks. As usual in this type of question, there were easy marks available for stating the main principles in the relevant standards.

Examining team's comments. Overall, the performance of candidates on this question was very pleasing. However, a number of specific issues arose in each part that future candidates for this exam may wish to note:

- In part (a) a number of candidates allocated the sale price between the two components of the transaction but then failed to develop their answers by explaining the differing pattern of revenue recognition that should have been applied to each component in the year ended 30 September 2014.



- In part (c), whilst the vast majority of candidates realised a provision was required for the damages payable to Chi (the plaintiff), a number of candidates incorrectly stated that the payment of damages was a non-adjusting event. A significant number of candidates, whilst correctly stating that a liability existed, referred to this liability as a 'contingent liability', indicating a lack of understanding of the meaning of the term 'contingent liability'.

[References: IFRS 15: paras. 22–23; IAS 37: para. 14]

Marking scheme

	Marks
(a) IFRS 15 <i>Revenue from Contracts with Customers</i> regards a transaction such as this as being made up of two separately identifiable performance obligations – the supply of the machine and the supply of the servicing agreement.	½
The total revenue of \$500,000 would need to be allocated between the two separate performance obligations in proportion to their stand-alone selling prices.	½
The selling price of the machine is \$450,000 and the normal selling price of the supply of services is \$150,000 ($4 \times \$37,500$). The total stand-alone selling prices therefore total \$600,000.	1
Revenue of \$375,000 ($\$500,000 \times 450,000/600,000$) is allocated to the supply of the machine. The balance of revenue of \$125,000 is allocated to the supply of services.	1 + ½
On 1 October 2013, Delta would recognise revenue from the supply of the machine of \$375,000.	½
On the same date Delta would recognise a receivable of \$500,000.	½
The balance of \$125,000 would initially be recognised as deferred income.	½
On 15 October 2013, the receivable of \$500,000 would be de-recognised when the payment was received from the customer.	½
In the year ended 30 September 2014, service revenue of \$31,250 ($\$125,000 \times \frac{1}{4}$) can be recognised.	1
The closing balance of deferred income on 30 September 2014 will be \$93,750 ($\$125,000 - \$31,250$).	½
\$31,250 of this balance will be shown as a current liability as this refers to service revenue to be recognised in the year ended 30 September 2015.	1
The balance of deferred income of \$62,500 ($\$125,000 - \$31,250 - \$31,250$) would be shown as a non-current liability.	<u>1</u> <u>9</u>

Summary of reported amounts (for tutorial purposes)

- Revenue from the supply of goods – \$375,000
- Revenue from the provision of services – \$31,250
- Cash balance – \$500,000
- Deferred income in non-current liabilities – \$62,500
- Deferred income in current liabilities – \$31,250



	Marks
(b) The construction cost of \$40m is shown in property, plant and equipment (PPE) from 1 October 2013.	½
On 1 October 2013, the obligation to dismantle the power station and restore the land is a present obligation arising out of a past event. Therefore it should be recognised as a provision.	1
The initial carrying amount of the provision is its discounted present value of \$7.81m ($\$55\text{m} \times 0.142$).	1
The debit entry for this provision is to PPE as the relevant expenditure provides access to future economic benefits.	½
Therefore the carrying amount of PPE at 1 October 2013 is \$47.81m ($\$40\text{m} + \7.81m).	½
In the year ended 30 September 2014, Delta would charge depreciation of \$1,195,250 ($\$47.81\text{m} \times 1/40$).	1
The carrying amount of PPE at 30 September 2014 (to be shown under non-current assets) would be \$46,614,750 ($\$47.81\text{m} - \$1,195,250$).	½ + ½
As the date for the dismantling approaches, the discount unwinds. The unwinding is shown as a finance cost.	½
The finance cost for the year ended 30 September 2014 is \$390,500 ($\$7.81\text{m} \times 5\%$).	½
This is added to the opening provision to give a closing provision of \$8,200,500 ($\$7.81\text{m} + \$390,500$).	½ + ½
The closing provision is shown as a non-current liability.	½
	<u>8</u>

Summary of reported amounts (for tutorial purposes)

- Depreciation – \$1,195,250
- Finance cost – \$390,500
- Provision in non-current liabilities – \$8,200,500

(c) The potential payment of damages to Chi is an obligation arising out of a past event which can be reliably estimated. Therefore, following IAS 37 <i>Provisions, Contingent Liabilities and Contingent Assets</i> a provision is required.	½ + ½
The provision should be for the best estimate of the expenditure required to settle the obligation at 30 September 2014.	½
Under the principles of IAS 10 <i>Events After the Reporting Period</i> evidence of the settlement amount is an adjusting event.	½
Therefore at 30 September 2014 a provision of \$18m should be recognised as a current liability .	½ + ½
	<u>3</u>
	<u>20</u>



5 Kolya (12/15)

Top tips. This question was on the new standard on revenue, IFRS 15. Part (a) required you to identify the five steps to be followed when recognising revenue and explain why a new standard was necessary. Part (b) required you to account for a transaction where goods and servicing were bundled together and to account for a transaction where a customer has rights of return.

Easy marks. Part (a) was straightforward book knowledge.

Examining team's comments. Part (a) was answered well by a majority of candidates. Most had clearly studied IFRS 15, were able to identify the 'five-step' approach to revenue recognition and make a sensible assessment of its likely impact. However a significant minority of candidates appeared unaware of the requirements of IFRS 15 and attempted to answer the question based on IAS 18 – its predecessor. Where this occurred, attempts were made by the marking team to award partial credit.

In part (b)(i) most candidates displayed an awareness that there were two performance obligations, one satisfied at a point in time and one satisfied over a period of time. On the whole candidates found the issue of measuring the total revenue and allocating this to the individual components more challenging and a variety of different mistakes were made here. It would be beneficial for future candidates to study the model answer to this part carefully. It should be noted that candidates who attempted to apply the provisions of IAS 18 to this scenario would not have been at a significant disadvantage since the treatment would have been much the same under the previous standard.

Answers to part (b)(ii) varied considerably. Candidates who had not studied IFRS 15 tended to either conclude that no revenue should be recognised until the return period expired or to conclude that revenue should be recognised in full, with a 'provision' for future refunds. Neither of these approaches fully accords with the IFRS 15 'expected value approach'. However, as with part (a) for such candidates attempts were made by the marking team to award partial credit.

A general message arising here for candidates is to ensure that they keep up to date with newly examinable standards.

[References: IFRS 15: paras. 9–10, 22, 25, 27, 29, 31–32]

Marking scheme

	Marks
(a)	
(i) The five steps to be followed are to:	
• Identify the contract(s) with the customer	½
• Identify the performance obligations the contract(s) create	½
• Determine the transaction price	½
• Allocate the transaction price to the separate performance obligations	½
• Recognise the revenue associated with each performance obligation as the performance obligation is satisfied	½
(ii) The IASB issued IFRS 15 because the existing criteria for revenue recognition outlined in IASs 11 and 18 were considered to be very subjective. Therefore it was difficult to verify the accuracy of the reported figures for revenue and associated costs.	½ + ½
One of the fundamental qualitative characteristics of useful financial information which is referred to in the IASB <i>Conceptual Framework</i> is faithful representation. Information needs to be verifiable in order to ensure it meets this fundamental characteristic. IFRS 15 provides a more robust framework upon which to base the revenue recognition decision, thus increasing the verifiability of the revenue figure and hence its usefulness.	½ + ½ + ½
	<u>5</u>

	Marks
(b)	
(i) Kolya has two performance obligations – to provide the machine and provide the servicing.	1
The total transaction price consists of a fixed element of \$800,000 and a variable element of \$10,000 or \$20,000.	1
The variable element should be included in the transaction price based on the probability of its occurrence. Therefore a variable element of \$10,000 should be included and the total transaction price will be \$810,000.	1
The transaction price should be allocated to the performance obligations based on their stand-alone fair values. In this case, these are \$700,000:\$140,000 or 5:1.	1
Therefore \$675,000 ($\$810,000 \times 5/6$) should be allocated to the obligation to supply the machine and \$135,000 ($\$810,000 \times 1/6$) to the obligation to provide two years' servicing of the machine.	$\frac{1}{2} + \frac{1}{2}$
The obligation to supply the machine is satisfied fully in the year ended 30 September 20X5 and so revenue of \$675,000 in respect of this supply should be recognised.	1
Only 1/24 of the obligation to provide the servicing is satisfied in the year ended 30 September 20X5 and so revenue of \$5,625 ($\$135,000 \times 1/24$) in respect of this supply should be recognised.	1
On 30 September 20X5, Kolya will recognise a receivable of \$810,000 based on the expected transaction price. This will be reported as a current asset.	$\frac{1}{2}$
On 30 September 20X5, Kolya will recognise deferred income of \$129,375 ($\$810,000 - \$675,000 - \$5,625$). \$67,500 ($\$129,375 \times 12/23$) of this amount will be shown as a current liability. The balance of \$61,875 ($\$129,375 - \$67,500$) will be non-current.	$\frac{1}{2} + \frac{1}{2} + \frac{1}{2} + \frac{1}{2}$ <u>+ $\frac{1}{2}$</u> <u>10</u>
(ii) When the customer has a right to return products, the transaction price contains a variable element.	1
Since this can be reliably measured, it is taken account of in measuring the revenue and the total revenue will be \$192,000 ($96 \times \$2,000$).	1
\$200,000 ($100 \times \$2,000$) will be recognised as a trade receivable.	1
\$8,000 ($\$200,000 - \$192,000$) will be recognised as a refund liability. This will be shown as a current liability.	1
The total cost of the goods sold is \$160,000 ($100 \times \$1,600$). Of this amount, only \$153,600 ($96 \times \$1,600$) will be shown as a cost of sale. The other \$6,400 ($\$160,000 - \$153,600$) will be shown as a right of return asset under current assets.	$\frac{1}{5}$ <u>20</u>

6 Shiplake

[References: IAS 36: paras. 6–12; IAS 38: paras. 51–67; IFRS 3: paras. 45–50]

- (a) (i) An impairment loss arises where the carrying amount of an asset, or group of assets, is higher than their recoverable amounts. In effect IAS 36 requires that assets should not appear on a statement of financial position at a value which is higher than they are 'worth'. The recoverable amount of an asset is defined as the higher of its fair value less costs of disposal (ie the amount at which it can be sold for net of direct selling expenses) or its value in use (ie its estimated future net cash flows discounted to a present value). IAS 36 *Impairment of Assets* recognises that many assets do not produce independent cash flows and therefore the value in use may have to be calculated for a group of assets – a cash-generating unit.

The standard recognises that it would be too onerous for companies to have to test for impairment every year and therefore only requires impairment reviews when there is some indication that an impairment has occurred. The exception to this general principle is where an intangible asset has an indefinite useful life, in which case an impairment review is required at least annually.

- (ii) Impairments generally arise where there has been an event or change in circumstances. It may be that something has happened to the assets themselves (eg physical damage) or there has been a change in the economic environment relating to the assets (eg new regulations may have come into force).

The standard gives several examples of indicators of impairment, which may be available from internal or external sources:

- (1) Poor operating results. This could be a current operating loss or a low profit. One year's losses in itself does not necessarily mean there has been an impairment, but if this is coupled with previous losses or expected future losses then this is an indication of impairment.
 - (2) A significant decline in an asset's market value (in excess of normal depreciation through use or the passage of time) or evidence of obsolescence (through market changes or technology) or physical damage.
 - (3) Evidence of a reduction in the useful life or estimated residual value of assets.
 - (4) Adverse changes in the market or economy such as the entrance of a major competitor, new statutory or regulatory rules or any indicator of value that has been used to value an asset (eg on acquisition a brand may have been valued on a 'multiple of sale revenues'. If subsequent sales were below expectations this may indicate an impairment).
 - (5) A commitment to a significant reorganisation or restructuring of the business.
 - (6) Loss of key employees or major customers.
 - (7) Increases in long-term interest rates (this could materially impact on value in use calculations thus affecting the recoverable amounts of assets).
 - (8) Where the carrying amount of an entity's net assets is more than its market capitalisation.
- (b) (i) On the acquisition of a subsidiary, the purchase consideration must be allocated to the fair value of its net assets with the residue being classed as goodwill (or negative goodwill if the assets have a greater fair value than the purchase consideration). IFRS 3 *Business Combinations* recognises that it is not always possible to accurately determine the value of some assets at the date of acquisition. Therefore adjustments to the provisional valuations may be made within 12 months of the acquisition date. As the revision to the value of Halyard's assets was due to more detailed information becoming available, the fall in its asset values should be treated as an adjustment to provisional valuations made at the time of acquisition. In effect, the net assets and goodwill should be restated to \$7m and \$5m respectively; the fall of \$1m is not an impairment loss and should not be charged to the statement of profit or loss.

The fall in value of Mainstay's assets is the result of events that occurred after the acquisition (ie physical damage to the plant) and this does constitute an impairment loss. The plant and machinery should be written down to its recoverable amount and the loss charged to the statement of profit or loss. On the assumption that the recoverable value of the company as a whole has not fallen, goodwill will not be affected.

- (ii) On the basis of the original estimates, Shiplake's earth-moving plant was not impaired, the value in use of \$500,000 being greater than its carrying amount. However due to the 'dramatic' increase in interest rates causing Shiplake's cost of capital to increase, the value in use of the plant will have to be recalculated. As the discount rate has risen this will cause the value in use to fall. There is insufficient information to be able to quantify this fall. If the new discounted value is above the carrying amount \$400,000 there is still no impairment. If it is between \$245,000 and \$400,000, this will be the recoverable amount of the plant and it should be written down to this value. As the plant can be sold for \$250,000 less selling costs of \$5,000, \$245,000 is the lowest amount that the plant should be written down to even if its revised value in use is below this figure.
- (iii) The treatment of the research and development costs in the year to 31 March 20X1 was correct due to the element of uncertainty at the date. The development costs of \$75,000 written off in that same period should not be capitalised at a later date even if the uncertainties leading to its original write off are favourably resolved. The treatment of the development costs in the year to 31 March 20X2 is incorrect. The directors' decision to continue the development is logical as (at the time of the decision) the future costs are estimated at only \$10,000 and the future revenues are expected to be \$150,000. It is also true that the project is now expected to lead to an overall deficit of \$135,000 ($120 + 75 + 80 + 10 - 150$ (in '\$'000)). However, at 31 March 20X2 the unexpensed development costs of \$80,000 are expected to be recovered. Provided the other criteria in IAS 38 *Intangible Assets* are met these costs of \$80,000 should be recognised as an asset in the statement of financial position and 'matched' to the future earnings of the new product. Thus the directors' logic of writing off the \$80,000 development cost at 31 March 20X2 because of an expected overall loss is flawed. The directors do not have the choice to write off the development expenditure.

7 Cash generating units

[References: IAS 36: paras. 6–12]

- (a) To determine whether impairment of an asset has incurred, it is necessary to compare the carrying amount of the asset with its **recoverable amount**. The recoverable amount is the **higher of fair value less costs of disposal and value in use**. It is not always easy to estimate value in use. In particular, it is not always practicable to identify cash flows arising from an individual non-current asset. If this is the case, value in use should be calculated as the level of **cash generating units**.

A cash generating unit is defined as a group of assets that generates cash flows that are largely independent of the reporting entity's other cash-generating units.

- (b)
 - (i) The cash-generating unit comprises **all the sites** at which the product can be made.
 - (ii) **Each restaurant is a cash-generating unit** by itself. However, any impairment of individual restaurants is unlikely to be material. A material impairment is likely to occur only when a number of restaurants are affected together by the same economic factors. It may therefore be acceptable to consider **groupings of restaurants** affected by the same economic factors rather than each individual restaurant.

- (c) It is now necessary to find the value in use in order to determine what the impairment loss is.

Year	Long-term growth rate	Future cash flows \$'000	PV factor at 10%	Discounted future cash flows \$'000
1		600	0.90909	545
2		660	0.82645	545
3		710	0.75131	533
4		755	0.68301	516
5		790	0.62092	491
6	+2%	806	0.56447	455
7	-1%	798	0.51316	409
8	-7%	742	0.46651	346
9	-16%	623	0.42410	264
10	-30%	436	0.38554	168
Total				<u>4,272</u>

The impairment loss is calculated by comparing the carrying amount (\$5m) with the higher of value in use (\$4.272m) and fair value less costs of disposal (\$3.2m). The impairment loss is therefore \$5m – \$4.272m = \$728,000. The new carrying amount of the SyMIX is \$4,272m.

8 Omikron

[References: IAS 36: paras. 6–12]

- (a) (i) Indicators will include the following.

External factors

- A significant decrease in the market value of an asset in excess of normal passage of time.
- Significant **adverse changes** in the **markets** or **business** in which the asset is used.
- Adverse changes to the **technological, economic** or **legal environmental** of the business.
- Increase in **market interest rates** likely to affect the **discount ratio** used in calculating **value in use**.
- Where interest rates increase, adversely affecting recoverable amounts.
- The carrying amount of an entity's asset exceeding its market capitalisation.

Internal factors

- Adverse changes to the method of use of the asset.
- Indications suggest the **economic performance** of the asset will be **worse** than expected.
- Physical damage or obsolescence has occurred.
- For new assets, **cost increases** adversely affect profitability.
- Where **actual cash flows are less than estimated** cash flows if an asset is valued in terms of 'value in use'.
- Where the **management** intend to **reorganise** the **entity**.

- (ii) **Recognition and measurement of impairment**

IAS 36 states that if an **asset's carrying amount** is **higher than** its **recoverable amount**, an **impairment loss** has occurred. The impairment loss should be **written off against profits**.

The **recoverable amount** is defined as the **higher of the asset's fair value less costs of disposal** and its **value in use**. If the recoverable amount is less than the carrying amount, then the resulting impairment loss should be charged as an expense in the statement of profit or loss. When an



impairment loss occurs for a revalued asset, the impairment loss should be charged to the revaluation surplus, any excess is then charged to the statement of profit or loss.

Where it is not possible to measure impairment for individual assets, the loss should be measured for a cash generating unit. **Impairment losses for cash generating units should be allocated initially to goodwill, then to all other assets on a pro rata basis.** Impairment losses should only be reversed if there has been a change in the estimates used to determine the asset's recoverable amount since the last impairment loss was recognised.

After impairment losses have been recognised, the depreciation (amortisation) charges should be revised.

(b) **Recommended treatment**

At 1 February 20X8

	1.1.X8 \$'000	Impairment loss \$'000	1.2.X8 \$'000
Goodwill (230 – 190)	40	(15)	25
Intangible assets	30		30
Vehicles	120	(30)	90
Sundry net assets	40		40
	<u>230</u>	<u>(45)</u>	<u>185</u>

An impairment loss is recognised for the stolen vehicles. The balance of \$15,000 is allocated to goodwill in the cash generating unit.

At 1 March 20X8

	1.2.X8 \$'000	Impairment loss \$'000	1.3.X8 \$'000
Goodwill	25	(25)	–
Intangible assets	30	(5)	25
Vehicles	90		90
Sundry net assets	40		40
	<u>185</u>	<u>(30)</u>	<u>155</u>

A further impairment loss of \$30,000 is recognised. The recoverable amount falls to the higher of net selling price (190 – 5 – 30) or value in use (150). There is no indication that other tangible assets are impaired. The loss is applied initially to the intangible assets and then to goodwill.

9 Omega 1 (12/06)

[References: IAS 16: paras. 48–58; IAS 37: para. 14; IAS 40: paras. 5, 32]

- (a) Properties 1 and 2 are items covered by IAS 16 *Property, Plant and Equipment*. This states that all items of property, plant and equipment with finite useful lives should be depreciated over those useful lives. Land normally has an infinite useful life and is therefore not depreciated, but the buildings element of the properties should be depreciated, regardless of whether the properties are measured at cost or at market value. Therefore the cost or valuation of the properties should be split between the land and buildings elements and depreciation charged on the buildings element.

Property 3 appears to meet the definition of an investment property and therefore IAS 40 *Investment Property* should be applied. Investment properties may be accounted for under the 'cost model' in which case the property is measured at cost and depreciated over its useful life in the same way as if it were an owner-occupied property covered by IAS 16. Alternatively, the 'fair value model', which is preferred by IAS 40 when fair values can be reliably measured, may be used. The property is measured at its fair value (market value) and is not depreciated. Instead, changes in fair value are recognised in profit or loss in the period in which they occur. Therefore non-depreciation would be appropriate in this case, provided that the fair value model was adopted.

- (b) All three properties can be measured at cost or at fair value. IAS 16 states that where an item is revalued, the entire class of assets to which that item belongs must be revalued. Properties would qualify as a separate class and it would be acceptable to measure Property 1 (which has risen in value) at fair value provided that Property 2 (which has fallen in value) was also measured at fair value.

Property 1

If the cost model is adopted, there will be no effect on the statement of profit or loss.

If the fair value model is adopted, a revaluation surplus of \$1m will be recognised directly in equity (a revaluation reserve), for each of the years ended 30 September 20X5 and 30 September 20X6.

Property 2

Again, if the cost model is adopted, there will be no effect on the statement of profit or loss. However, the fact that the fair value of the property has fallen below cost means that it may have become impaired. An impairment review should be performed as required by IAS 36 *Impairment of Assets*.

If the fair value model is adopted, the entity will recognise a revaluation surplus of \$1m in other comprehensive income for the year ended 30 September 20X5. For the year ended 30 September 20X6 it must recognise a revaluation deficit of \$2m. There already exists a revaluation surplus of \$1m in respect of the property, so \$1m of the deficit is recognised in equity and set against the surplus. The remaining loss of \$1m is recognised immediately in profit or loss for the year.

Property 3

Investment properties may be measured at cost. If this treatment is adopted, there will be no effect on the statement of profit or loss.

If the property is measured at fair value, revaluation gains of \$1.5m (for the year ended 30 September 20X5) and \$1m (for the year ended 30 September 20X6) will be recognised directly in the statement of profit or loss.

- (c) The cost of the site is recognised in property, plant and equipment and depreciated over its useful life of ten years as required by IAS 16 *Property, Plant and Equipment*.

The entity has a legal obligation to incur restoration costs of \$15m at the end of ten years. The obligation exists from the date at which the site was purchased, ie 1 October 20X5. Therefore it should recognise a provision at that date, as required by IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. The time effect of money is material and IAS 37 requires that the provision is discounted to its present value of \$6.945m ($\$15m \times 0.463$).

IAS 16 requires that the cost of an asset should include an initial estimate of the cost of restoring the site, where the entity has an obligation to do so. Therefore an amount of \$6.945m is recognised in property, plant and equipment and is also depreciated over ten years.

The provision is increased over time as the discount unwinds. The amount of the discount is recognised in profit or loss as a finance cost.

The statement of profit or loss for the year ended 30 September 20X6 includes the following amounts:

- Depreciation of \$5,694,500 ($(\$50m + \$6.945m) \div 10$). This is included in operating costs.
- Unwinding of the discount of \$556,000 ($\$6.945m \times 8\%$). This is included in finance costs.

The statement of financial position at 30 September 20X6 includes the following amounts:

- Property, plant and equipment of \$51.2505m ($\$56.945m \times 9/10$). This is included in non-current assets.
- Provision of \$7.501m ($\$6.945m + \$556,000$). This is included in non-current liabilities.

10 Omega 10 (6/10)

Top tips. This question divides itself neatly into two parts, and there were plenty of marks available in both halves. The first part was relatively straightforward, but you would have needed to take care with the numbers in order to score well. Regarding part (b), if you had kept to your timings throughout the first three questions then there were easy pickings essentially for applying the basic provisions of IFRS 5. This is a fundamental standard that you should be very familiar with.

Examining team's comments. Answers to part (a) were generally very satisfactory. Most candidates seemed aware of the basic principles of which costs could be capitalised and which could not. There was generally a satisfactory awareness of the requirement to capitalise relevant borrowing costs, although few candidates were wholly accurate in their calculations. Similarly, the principle of component depreciation seemed well known but very candidates produced correct calculations. A common calculation error was to add the expected replacement cost of the roof onto the other costs when computing the overall carrying amount.

Answers to part (b) were somewhat disappointing. Many candidates failed to recognise that the decline in value of property A was caused by an event after the end of the reporting period and so would be classified as non-adjusting. Many candidates did not appreciate that property B could not be classified as held for sale until the necessary repair work was carried out. A number of candidates seemed to confuse 'held for sale' with 'available for sale'. However if the principles of IFRS 5 were applied correctly no candidate was penalised for referring to the properties as 'available for sale'.

[References: IFRS 5: paras. 7–8]

Marking scheme

	Marks
(a) Marks as indicated on answers	12
(b) Conclusions about classification as held for sale	1 each
Depreciation of property A	1
Measurement and disclosure of property A in statement of financial position	2
Depreciation of property B	1
Identify and discuss impairment issue with property B	1
Disclosure of property B in statement of financial position	1
Total for event 2	8
Total	20

(a)

Computation of cost (all numbers in \$'000)

Details	Amount	Explanation	
Purchase of land	20,000	Direct cost of construction	1
Purchase of materials	7,500	Not including cost of materials lost in fire	1½
Costs of construction workers	2,250	Construction period five months, less idle two weeks	1½
Other construction overheads	900	Construction period as above. Ignore overheads incurred after construction complete	1½
Consultants fees	500	Direct cost of construction	1
Income from car park	Nil	Income from operations incidental to the construction taken to the statement of profit or loss and other comprehensive income	1½
Costs of opening factory	Nil	Not a direct cost of construction	1
	<u>31,150</u>		



Computation of depreciation charged to 31 March 20X9**Marks**

Depreciate from 1 April 20X8 (the date available for use)

1

The depreciable amount is 11,150 (31,150 – 20,000)

 $\frac{1}{2}$ The depreciation for the year is 339 ($2,400 \times \frac{1}{20} + (11,150 - 2,400) \times \frac{1}{40}$) $\frac{1}{2}$ **Computation of carrying amount at 31 March 20X9**

Cost 31,150

 $\frac{1}{2}$

Depreciation (339)

 $\frac{1}{2}$ 30,81112

Tutorial note. The need to replace the roof in 20 years' time is recognised through component depreciation rather than by recognising a provision.

(b) **(All numbers in \$'000)****Statement of financial position at 31 March 20X9** \$'000

Non-current assets 18,000

Current assets (or non-current assets held for sale) 24,625

Statement of profit or loss and other comprehensive income for the year ended 31 March 20X9

\$'000

Depreciation (375 + 400) 775

Impairment (21,600 – 18,000) 3,600

From 1 January 20X9 property A would be regarded as held for sale under the principles of IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*. The property is available for immediate sale in its present condition and is being actively marketed at a reasonable price. On the other hand property B would not, since it cannot be sold until necessary repairs are carried out.

Property A would be depreciated up to the date of classification as held for sale but not thereafter. Therefore, depreciation of 375 ($15,000 \times \frac{1}{30} \times \frac{9}{12}$) would be necessary in the year to 31 March 20X9. The property would be removed from non-current assets and shown in current assets or in a separate section of the assets side of the statement of financial position. It would be measured at the lower of its carrying amount of the date of classification of 24,625 ($25,000 - 375$) and its fair value less costs to sell of $28,000 - 24,625$ in this case. The decline in property prices affecting this property relates to an economic event occurring after the end of the reporting period. Therefore, it would be regarded as a non-adjusting event after the reporting period. The event would be disclosed as a note to the financial statements but the decline in value would not be recognised.

Property B would be depreciated for the whole period and would remain in non-current assets. The depreciation required for the year ended 31 March 20X9 would be 400 ($16,000 \times \frac{1}{40}$). The fact that its fair value less costs to sell is estimated at \$18m whilst the carrying amount prior to any write down is 21,600 ($22,000 - 400$) is prima-facie evidence of impairment. Given that the property is to be sold – even though it cannot be classified as held for sale at 31 March 20X9 – this is the best indicator of the recoverable amount of the property.



11 Leases

[References: IFRS 16: paras. 9, B9, 23–32, 99–100]

(a) Lease

The issue here is whether the arrangement with the private sector provider Waste and Co is, or contains, a lease, even if it does not take the legal form of a lease. The **substance of the arrangement should be considered** in connection with the IFRS 16 *Leases*. Key factors to consider are as follows.

- (i) Is there an **identifiable asset**?
- (ii) Does the customer have the right to **obtain substantially all the economic benefits** from use of the asset throughout the period of use?
- (iii) Who has the **right to direct how and for what purpose the asset is used**?
- (iv) Does the customer **have the right to operate the asset throughout the period of use** without the supplier having the right to change those operating instructions?

The answer in each case is yes.

- (i) The vehicles are an identifiable asset. Although Waste and Co can substitute another vehicle if one of the existing vehicles needs repairing or no longer works, this substitution right is not substantive because of the significant costs involved in fitting out the vehicle for use by Blackcutt.
- (ii) Blackcutt can use the vehicles and uses them exclusively for waste collection for nearly all their life. It therefore has a right to obtain substantially all the economic benefits from the use of the asset.
- (iii) Blackcutt controls the vehicles, since it stipulates how they are painted, and ostensibly owns them because they must be painted with Blackcutt's name. It therefore has the right to direct how and for what purpose the asset is used.
- (iv) As indicated in (ii) above, Blackcutt has the right to operate the asset throughout the period of use, although it has outsourced the driving to Waste and Co.

The arrangement is a **lease**. A **right-of-use asset** should be recorded, and a **lease liability** set up, equal to the present value of the lease payments.

(b) Lease accounting

A right-of-use asset of \$24.4m should be recognised in Heggie's financial statements. This is comprised of the \$24m present value of lease payments **not** paid at the 1 January 20X1 commencement date plus the 'initial direct costs' incurred in setting up the lease of \$0.4m.

The asset should be depreciated from the commencement date (1 January 20X1) to the earlier of the end of the asset's useful life (four years) and the end of the lease term (five years) unless legal title reverts to the lessee at the end of the lease term. Here, as the legal title remains with the lessor, the asset should be depreciated over four years, giving an annual depreciation charge of \$6.1m ($\$24.4/4$ years) and a carrying amount of \$18.3m at 31 December 20X1.

A lease liability should initially be recognised on 1 January 20X1 at the present value of lease payments **not** paid at the commencement date. This amounts to \$24m. An annual finance cost of 8% of the carrying amount should be recognised in profit or loss and added to the liability. The first lease instalment on 31 December 20X1 is then deducted from the liability, giving a carrying amount of (see Working) \$19.9m at 31 December 20X1.

Working:

Lease liability

	\$m
b/d at 1 January 20X1	24.0
Interest ($24 \times 8\%$)	1.9
Instalment in arrears	(6.0)
c/d at 31 December 20X1	19.9
Interest ($19.9 \times 8\%$)	1.6
Instalment in arrears	(6.0)
c/d at 31 December 20X2	15.5

The lease liability at 31 December 20X1 is split between current and non-current:

	\$m
Non-current liability (owed at 31 December 20X1)	15.5
Current liability (bal. fig.) = instalment (0.441) less finance cost (0.344)	4.4
Total liability at 31 December 20X1	19.9

(c) **Sale and leaseback**

There is a **sale and leaseback**. IFRS 16 requires an initial assessment to be made regarding whether or not the transfer constitutes a sale. This is done by determining when the performance obligation is satisfied in accordance with IFRS 15 *Revenue from Contracts with Customers*. In this case, we are told in the question that the IFRS 15 criteria have been met. IFRS 16 therefore requires that, at the start of the lease, William should measure the right-of-use asset arising from the leaseback of the building at the proportion of the previous carrying amount of the building that relates to the right-of-use retained. This is calculated as carrying amount \times present value of lease payments/fair value. The present value of lease payments was given in the question as \$5m, which is the lease liability.

For William, the right-of-use asset is therefore: $\$3.6m \times \$5m/\$6m = \$3m$.

William only recognises the amount of gain that relates to the rights transferred. The gain on sale of the building is \$2,400,000 ($\$6,000,000 - \$3,600,000$), of which:

$\$2,400,000 \times 5,000,000/6,000,000 = \$2,000,000$ relates to the rights retained.

The balance, $\$2,400,000 - \$2,000,000 = \$400,000$, relates to the rights transferred to the buyer.

At 1 June 20X2, William should account for the transaction as follows:

	Debit	Credit
	\$	\$
Cash	6,000,000	
Right-of-use asset	3,000,000	
Building		3,600,000
Financial liability		5,000,000
Gain on rights transferred		400,000
	<u>9,000,000</u>	<u>9,000,000</u>

The right-of-use asset will be depreciated over 20 years, which is the shorter of the lease term and the remaining useful life, $\$3m \div 20 \text{ years} = \$0.15m$:

DEBIT	Depreciation expense	\$0.15m
CREDIT	Accumulated depreciation	\$0.15m

The financial liability will be increased each year by the interest charge and reduced by the lease payments.

The finance cost on the lease liability is charged at the implicit rate of 7% to profit or loss for the year ended 31 May 20X3. The amount is calculated as follows:

Lease liability

	\$m
1 June 20X2 b/f	5.000
Finance cost: $5m \times 7\%$	0.350
Instalment	(0.441)
31 May 20X3 c/f	4.909
Finance cost: $4.909m \times 7\%$	0.344
Instalment	(0.441)
31 May 20X4 c/f	<u>4.812</u>

The lease liability at 31 May 20X3 is split between current and non-current:

	\$m
Non-current liability (owed at 31 May 20X4)	4.812
Current liability (bal. fig.) = instalment (0.441) less finance cost (0.344)	0.097
Total liability at 31 May 20X3	<u>4.909</u>

12 Grimble Co

[References: IFRS 16: paras. 61–84]

(a) Memorandum

To: Managing director
 From: Financial director
 Date: 17 May 20X9
 Subject: Accounting for leases

(i) Factors determining type of lease for a lessor – finance or operating

In deciding whether a particular lease should be classified as a finance or operating lease the substance of the transaction should be considered, rather than its strict legal form. The determining factor is who has the **risks and rewards of ownership**. For a finance lease, the risks and rewards of ownership are transferred to the lessee. For an operating lease, the risks and rewards remain with the lessor.

Finance lease

In deciding whether the lease is a finance lease, IFRS 16 give examples of situations that individually or in combination would normally lead to a lease being classified as a finance lease:

- (1) The lease **transfers ownership** of the underlying asset to the lessee by the end of the lease term;
- (2) The lessee has the **option to purchase** the underlying asset at a price expected to be **sufficiently lower than fair value** at the exercise date, that it is reasonably certain, at the inception date, that the option will be exercised;
- (3) The lease term is for a **major part of the useful life** of the underlying asset even if title is not transferred;
- (4) The present value of the lease payments at the inception date amounts to at least **substantially all** of the fair value of the underlying asset; and
- (5) The underlying asset is of such **specialised** nature that only the lessee can use it without major modifications.



Additionally the following **could** lead to a lease being classified as a finance lease:

- (1) Any losses on cancellation are borne by the lessee;
 - (2) Gains/loss on changes in residual value accrue to the lessee; and
 - (3) The lessee can continue to lease for a secondary term at a rent substantially lower than market rent.
- (ii) IFRS 16 says that a lessor should classify a lease as a finance lease if substantially all of the risks and rewards of ownership have been transferred to the lessee.

One factor identified by IFRS 16 is whether the present value of the lease payments is equal to substantially all of the fair value of the leased asset.

The lease payments that need to be discounted are:

- The five annual instalments of \$20,000 each
- The residual value of \$15,000 guaranteed by the lessee

The IFRS requires the lease payments to be discounted using the rate implicit in the lease which is 10%.

<i>Time</i>	<i>Cash flow</i>	<i>Discount factors</i>	<i>Present value</i>
0	20,000	1	20,000
1	20,000	1/1.1	18,182
2	20,000	1/(1.1) ²	16,529
3	20,000	1/(1.1) ³	15,026
4	20,000	1/(1.1) ⁴	13,660
5	15,000	1/(1.1) ⁵	9,314
			<u>92,711</u>

The present value of the lease payments (\$92,711) does not exceed the \$100,000 fair value of the asset, but is more than 90% of it, and can therefore be considered to be substantially all of the fair value. Consequently, there is substantial evidence that the lease should be classified as a finance lease under the provisions of IFRS 16 since substantially all the risks and rewards of ownership appear to have been transferred.

- (b) The arrangement is a finance lease as the lessee uses the asset for all of its useful life and the present value of lease payments is substantially all of the fair value of the asset of \$25.9 million.

Grimble Co recognises a lease receivable on 1 January 20X5, the commencement date of the lease, equal to:

	\$m
Present value of lease payments receivable	25.9
Present value of unguaranteed residual value (3m – 2m = 1m × 0.618)	<u>0.6</u>
	<u>26.5</u>

In the year ended 31 December 20X5, Grimble Co recognises interest income of (W1) \$1.6 million and a lease receivable of (W1) \$24.1 million at 31 December 20X5.

Working:

Lease receivable

	\$m
b/d at 1 January 20X5	26.5
Interest at 8% (26.5 × 6.2%)	1.6
Lease payment	<u>(4.0)</u>
c/d at 31 December 20X5	<u>24.1</u>



- (c) Grimble retains the risks and rewards of ownership of the property evidenced by the fact that the lease is only for a small portion of the useful life of the property and the fact that Grimble is responsible for maintenance of the property during the lease term. As such, the lease is an operating lease.

The benefit received from the asset is earned over the five years of the lease. However, in the first year, Grimble only receives $\$100,000 \times 6/12 = \$50,000$. Lease rentals of $\$450,000$ ($\$50,000 + (\$100,000 \times 4 \text{ years})$) are received over the five-year lease term.

In accordance with IFRS 16, Grimble should recognise income of $\$90,000$ ($\$450,000/5 \text{ years}$) in the year to 31 December 20X5, and in each of the following four years.

A receivable of $\$40,000$ should be recognised at 31 December 20X5 ($\$90,000 - \$50,000 \text{ cash received}$).

13 Delta (6/15) (amended)

Top tips. This question covered two distinct topics. With both parts, start by explaining the required treatment and then apply it to the scenario in the question, with calculations where possible.

Part (b) financial instruments may have been initially daunting, but this question was actually relatively straightforward.

Part (a) covered sale and leaseback transactions. Because the fair value of the proceeds for the sale did not equal the fair value of the asset sold, the shortfall of consideration received from the lessor is treated as a prepayment of lease payments by the lessee. This question has been updated for IFRS 16.

Examining team's comments. On the whole, candidates found part (b) of this question challenging. A number of candidates did not identify that the share option was a derivative which needed to be measured at fair value through profit or loss. The majority of candidates realised that the shares that were purchased by the exercising of the option needed to be measured at fair value. However many candidates stated that the measurement basis should have been fair value through other comprehensive income, despite the question making it clear that these shares were part of a trading portfolio. This should have led candidates to conclude that the shares should be measured at fair value through profit or loss. As a result many candidates incorrectly stated that the transaction costs should be included in the initial carrying value of the equity investment, rather than being immediately taken to profit or loss.

[References: IFRS 9: paras. 4.1.1–4.1.5, 5.1.1; IFRS 16: paras. 99–100]

Marking scheme

	Marks
(a)	
As a sale has occurred, the carrying amount of the hotel asset of \$57 million must be derecognised.	1
Per IFRS 16, a right-of-use asset should then be recognised at the proportion of the previous carrying amount that relates to the right of use retained . This amounts to \$8.2 million ($\$50\text{m carrying amount} \times \$9\text{m present value of lease payments}/\55m fair value).	1
As the fair value of \$55 million is in excess of the proceeds of \$48 million, IFRS 16 requires the excess of \$7 million ($\$55\text{m} - \48m) to be treated as a prepayment of the lease rentals. Therefore, the \$7 million prepayment must be added to the right-of-use asset, bringing the right-of-use asset to \$15.2 million ($\$8.2\text{m} + \7m).	1
A lease liability must also be recorded at the present value of lease payment of \$9 million.	1

Marks

A gain on sale is recognised in relation to the rights transferred to the buyer-lessor. The total gain would be \$5 million (\$55m fair value – \$50m carrying amount). The portion recognised as a gain relating to the rights transferred is \$4.2 million (\$5m gain × (\$55m – \$9m)/\$55m portion of fair value transferred).

1 + 1

On 1 April 20X4, the double entry to record the sale is:

1

DEBIT	Cash	\$48m	
DEBIT	Right-of-use asset	\$15.2m	
CREDIT	Property asset		\$50m
CREDIT	Lease liability		\$9m
CREDIT	Gain on sale (P/L)		\$4.2m

The lease liability is increased for interest and reduced for the lease liability, giving a carrying amount of the lease liability at 31 March 20X5 of \$8.53m (W1). The interest of \$0.53m is charged to profit or loss as a finance cost.

1

The proportion of the carrying amount of the property relating to the right of use retained of \$15.2m (including the \$7m lease prepayment) remains as a right-of-use asset in the statement of financial position and is depreciated over the lease term:

1

DEBIT	P/L (\$15.2m/10 years)	\$1.52m	
CREDIT	Right-of-use asset		\$1.52m

This results in a net credit to profit or loss for the year ended 31 April 20X5 of \$2.15m (\$4.2m – \$0.53m – \$1.52m).

1

Working:

1

Lease liability for the year ending 31 March 20X5

	\$m
b/d at 1 April 20X4	9.00
Interest (9 × 5.9%)	0.53
Lease payment	(1.00)
c/d at 31 March 20X5	<u>8.53</u>

11

(b)

Under the provisions of IFRS 9 *Financial Instruments* the option to acquire shares in Epsilon would be regarded as a derivative financial instrument.

½

This is because the value of the option depends on the value of an underlying variable (Epsilon's share price), it requires a relatively small initial investment and it is settled at a future date.

½

A derivative financial instrument is initially measured at its fair value.

½

In this case fair value will be the price paid – which is \$250,000 at 1 April 20X4.

½

Derivative financial instruments are remeasured to fair value at the reporting date and gains or losses on remeasurement recognised in the statement of profit or loss.

½

However, in this case the derivative is derecognised on 31 December 20X4, when the option is exercised.

½

On 31 December 20X4, the investment in Epsilon's shares would be regarded as a financial asset.

½

Under IFRS 9, financial assets are initially measured at fair value, so the initial carrying value of the shares in the books of Delta will be \$2.6m (1 million × \$2.60).

½



The difference between the carrying value of the new asset – \$2.6m and the price paid plus the derecognised derivative – \$2.25m (\$2m + \$250,000) will be taken to profit or loss for the year ended 31 March 20X5 as investment income. In this case \$350,000 will be included as investment income.	Marks ½ + ½
Because the investment in Epsilon is an equity investment, it will continue to be remeasured to fair value at each year end.	1
Because the investment is part of a trading portfolio, the investment is measured at fair value through profit or loss.	½
Therefore the acquisition costs of \$100,000 must be recognised as an expense in the statement of profit or loss for the year ended 31 March 20X5.	½
The investment is included in the statement of financial position at 31 March 20X5 as a current asset at its fair value of \$2.9m.	½ + ½
The increase in fair value of \$300,000 (\$2.9m – \$2.6m) is taken to the statement of profit or loss.	½ + ½
	<u>9</u>

14 Dougal (12/15)

Top tips. This is another typical question requiring you to explain three different issues. Part (a) required you to recognise and account for an investment property. You also had to consider the accounting treatment of the property when it changed use. Note that IFRS 16 *Leases* retains the distinction between finance and operating leases for lessors, though not for lessees. Part (b) required you to account for a purchase of a machine from overseas and to contrast the treatment of the machine itself (non-monetary item) with the liability (monetary). Part (c) required you to account for a share-based payment. Note that this topic appears in almost every exam.

Easy marks. As usual in this type of question, there were easy marks available for stating the main principles in the relevant standards. Parts (b) and (c) in particular were quite straightforward. Don't forget that you have to explain the accounting treatment in order to get a good mark.

Examining team's comments. On the whole, candidates found part (a) of this question challenging. Many candidates did not appreciate that the property being leased out was an investment property, so that fair value changes would be recognised in profit or loss rather than other comprehensive income (as would generally be the case for property, plant and equipment under IAS 16). A number of candidates wasted time by reflecting on the type of lease when the scenario clearly stated that the lease was operating. Some candidates spent time reflecting on the way fair value was arrived at when the question did not ask this. Answers to the second half of part (a), post-repossession of the property, were generally unsatisfactory. A number of candidates failed to consider this issue at all, focussing instead on the time-wasting activities already mentioned. A number of others incorrectly stated that the property would satisfy the 'held-for-sale' criteria in IFRS 5. Others regarded the conversion project as a construction contract when no evidence was provided of the existence of any third-party buyers to support this. Only a minority correctly applied IAS 2 to this situation.

Part (b) of this question was generally well answered by the majority of candidates attempting it. However a significant minority of candidates made a careless error of multiplying the foreign currency (groat) figure to convert into \$ rather than dividing it. A smaller minority of candidates seemed unaware of the distinction between monetary and non-monetary items in a 'foreign currency context'. Therefore there were some examples of the 're-translation' of PPE, which was not appropriate. A minority of candidates incorrectly stated that the exchange differences on re-translation should be recognised in other comprehensive income rather than profit or loss.

Part (c) of this question was well answered on the whole, with a number of candidates scoring full marks. Some candidates lost marks by failing to appreciate that, in an equity-settled share-based payment transaction, the credit entry is to equity rather than to liabilities.

[References: IAS 21: paras. 21–23; IAS 40: paras. 5, 21, 57; IFRS 2: paras. 2, 7–8, 14; IFRS 16: paras. 61–84]



Marking scheme

	Marks
(a)	
From 1 October 20W0, the property would be regarded as an investment property since it is being held for its investment potential rather than being owner occupied or developed for sale.	$\frac{1}{2} + \frac{1}{2}$
The property would be measured under the fair value model . This means it will be measured at its fair value each year end, with any gains or losses on remeasurement recognised in profit or loss .	$\frac{1}{2} + \frac{1}{2}$
On 31 March 20X5, the property ceases to be an investment property because Dougal begins to develop it for sale as flats.	$\frac{1}{2} + \frac{1}{2}$
The increase in the fair value of the property from 30 September 20X4 to 31 March 20X5 of \$3m (\$29m – \$26m) would be recognised in P/L for the year ended 30 September 20X5.	$\frac{1}{2} + \frac{1}{2}$
Since the lease of the property is an operating lease, rental income of \$1m (\$2m \times 6/12) would be recognised in P/L for the year ended 30 September 20X5.	$\frac{1}{2} + \frac{1}{2}$
When the property ceases to be an investment property, it is transferred into inventory at its then fair value of \$29m. This becomes the initial 'cost' of the inventory.	$\frac{1}{2} + \frac{1}{2}$
The additional costs of \$6m for developing the flats which were incurred up to and including 30 September 20X5 would be added to the 'cost' of inventory to give a closing cost of \$35m .	$\frac{1}{2}$
The total selling price of the flats is expected to be \$50m (10 \times \$5m). Since the further costs to develop the flats total \$4m , their net realisable value is \$46m (\$50m – \$4m), so the flats will be measured at a cost of \$35m.	$\frac{1}{2} + \frac{1}{2} + \frac{1}{2} + \frac{1}{2}$
The flats will be shown in inventory as a current asset .	$\frac{1}{2}$ <u>9</u>
(b)	
The machine and the associated liability would be recorded in the financial statements using the rate of exchange in force at the transaction date – 2.5 groats to \$1. Therefore the initial carrying amount of both items is \$240,000 (600,000/2.5).	1
The liability is a monetary item so it would be retranslated at the year end of 30 September 20X5 using the closing rate of 2 groats to \$1 at \$300,000 (600,000/2) and shown as a current liability .	1 + $\frac{1}{2}$
The exchange difference of \$60,000 (\$300,000 – \$240,000) is recognised in profit or loss – in this case a loss.	1
The machine is a non-monetary asset measured under the cost model and so is not retranslated as the exchange rate changes.	1
The modification costs of \$30,000 are added to the cost of the machine to give a total cost figure of \$270,000.	$\frac{1}{2}$
The machine is depreciated from 1 September 20X5 (the date it is brought into use) and so the depreciation for the year ended 30 September 20X5 is \$4,500 (\$270,000 \times 1/5 \times 1/12).	1
The machine will be shown as a non-current asset at a closing carrying value of \$265,500 (\$270,000 – \$4,500).	$\frac{1}{7}$ <u>7</u>



	Marks
(c)	
This equity settled share based payment arrangement should be measured using the fair value of an option on the grant date – \$3.00 in this case.	1
The revenue for the year ended 30 September 20X5, plus the expected revenue for the next two years, indicates that the cumulative revenue for the three years ended 30 September 20X7 is likely to be \$190m. Therefore the number of options vesting for each director is likely to be 200.	1
This means that the charge to P/L for the year ended 30 September 20X5 should be \$20,000 ($100 \times 200 \times \$3.00 \times 1/3$).	1
The credit entry should be to other components of equity.	1
	<u>4</u>
	<u>20</u>

15 Dexterity

BPP Study Text reference. Chapter 7.

Top tips. Part (a) is a test of memory. Follow the structure given to you in the question; discuss three situations (purchase, business combination, internal generation) for two assets (goodwill and other intangibles). Even if you only say a little about each situation, this gives you a minimum of six marks out of ten.

Part (b) requires you to apply theory. Explain both the correct treatment and why alternative treatments have been rejected. For example in (b)(ii) explain why \$12m can be capitalised and why \$20m can't be.

Easy marks. If you know the standards, then part (a) should be 10 easy marks.

[References: IFRS 3: para. 13, Appendix A; IAS 38: para. 52–54, 63]

Marking scheme

	Marks
(a) Recognition and amortisation	
<i>Goodwill</i>	
Only goodwill arising from a business combination is recognised. Under IFRS 3, goodwill is the excess of the cost of a business combination over the acquirer's interest in the net fair value of the assets, liabilities and contingent liabilities of the business acquired . Once recognised goodwill is held indefinitely, without amortisation but subject to impairment reviews .	1 + 1
One of the key aspects of goodwill is that it cannot be separated from the business that it belongs to. Therefore goodwill cannot be purchased separately from other assets. In addition, IAS 38 states that internally generated goodwill must not be capitalised .	1
<i>Other intangible assets</i>	
Other intangibles can be recognised if they can be distinguished from goodwill ; typically this means that they can be separated from the rest of the business, or that they arise from a legal or contractual right.	1 + 1

Marks

Intangibles acquired as **part of a business combination** are recognised at fair value provided that they can be **valued separately from goodwill**. The acquirer will recognise an intangible **even if the asset had not been recognised previously**. If an intangible cannot be valued, then it will be subsumed into goodwill.

1 + 1

Internally generated intangibles can be recognised if they are **acquired as part of a business combination**. For example, a brand name acquired in a business combination is capitalised whereas an internally generated brand isn't. Expenditure on research cannot be capitalised. **Development expenditure** is capitalised if it meets the IAS 38 criteria. It is then amortised over the life-cycle of the product.

1 + 1

Goodwill and intangibles with an indefinite useful life are **not amortised but tested annually for impairment**.

$$\frac{1}{10}$$
(b) **Dexterity**(i) *Temerity*

The following assets will be recognised on acquisition:

	\$m	
Fair value of sundry net assets	15	1
Patent at fair value	10	1
Research carried out for customer	2	1
Goodwill (balancing figure)	8	1
Total consideration	<u>35</u>	

The patent is recognised at its fair value at the date of acquisition, even if it hadn't previously been recognised by Temerity. It will be amortised over the remaining eight years of its useful life with an assumed nil residual value.

The higher value of \$15m can't be used because it depends on the successful outcome of the clinical trials. The extra \$5m is a contingent asset, and contingent assets are not recognised in a business combination. (Only assets, liabilities and contingent liabilities are recognised.)

Although research is not capitalised, this research has been carried out for a customer and should be recognised as work-in-progress in current assets. It will be valued at the lower of cost and net realisable value unless it meets the definition of a construction contract.

The goodwill is capitalised at cost. It is not amortised but it will be tested for impairment annually.

(ii) *New drug*

Under IAS 38 the \$12m costs of **developing** this new drug are capitalised and then amortised over its commercial life. (The costs of **researching** a new drug are never capitalised.)

1 + 1

Although IAS 38 permits some intangibles to be held at valuation it **specifically forbids revaluing patents**, therefore the \$20m valuation is irrelevant.

1

(iii) *Advertising costs*

IAS 38 Paragraph 69 states that advertising and promotional costs should be **recognised as an expense when incurred**. This is because the expected future economic benefits are uncertain and they are **beyond the control** of the entity.

1 + 1

However, because the year end is half way through the campaign there is a **\$2.5m prepayment** to be recognised as a current asset.

1



16 Darby

BPP Study Text references. Chapters 1, 4, 5 and 7.

Top tips. It was important for this question to know the IASB definition. This made it possible to do a good answer to part (a) and know where you were going with part (b). It was important to spend time on all parts of the question and read the scenarios carefully.

Easy marks. This was all quite easy until you got to (b) (iii), which was a slightly confusing scenario. The clue was in 'the assistant **correctly** recorded the costs', which would have told you that the point at issue was the impairment write-down.

[References: Conceptual Framework: para. 4.4; IAS 38: paras. 15, 52–54]

Marking scheme

		Marks
(a)	The IASB <i>Conceptual Framework</i> defines an asset as 'a resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity'. IAS 1 sets out the defining features of a current asset (intended to be realised during the normal operating cycle or within 12 months of the year end, held for trading or classified as cash or a cash equivalent). All other assets are classified as non-current.	
	The assistant's definition diverges from this in a number of ways:	
	(i) A non-current asset does not have to be physical . The definition can include intangible assets such as investments or capitalised development costs.	1
	(ii) A non-current asset does not have to be of substantial cost . An item of immaterial value is unlikely to be capitalised, but this is not part of the definition.	1
	(iii) A non-current asset does not have to be legally owned. The accounting principle is based on 'substance over form' and relies on the ability of the entity to control the asset. This means for instance that a lease gives rise to a right-of-use asset in the financial statements of the lessee in accordance with IFRS 16, even though legal title of the leased asset remains with the lessor.	1
	(iv) It is generally the case that non-current assets will last longer than one year. IAS 16 specifies that property, plant and equipment 'are expected to be used during more than one period'. However, if a non-current asset failed to last longer than one year, it would still be classified as a non-current asset during its life .	<u>1</u> 4
(b)	(i) IAS 38 makes the point that 'an entity usually has insufficient control over the expected future economic benefits arising from a team of skilled staff'. This is the case in this situation. Darby's trained staff may stay with the company for the next four years or they may decide to leave and take their skills with them. Darby has no control over that. For this reason, the expenditure on training cannot be treated as an asset and must be charged to profit or loss.	<u>1 + 1 + 1</u> 3
	(ii) The work on the new processor chip is research with the aim of eventually moving into development work. IAS 38 requires all research expenditure to be expensed as incurred. Even at the development stage, it will not be possible to capitalise the development costs unless they satisfy the IAS 38 criteria . When the criteria are satisfied and development costs can be capitalised, it will still not be possible to go back and capitalise the research costs. The company's past successful history makes no difference to this.	1 + 1 + 1



Marks

The research work on the braking system is a different case, because here the work has been commissioned by a customer and the customer will be paying, regardless of the outcome of the research. In this situation, as long as Darby has no reason to believe that the customer will not meet the costs in full, the **costs should be treated as costs relating to a contract with a customer** where performance obligations are satisfied over time and included on the statement of financial position as a contract asset rather than being charged to profit or loss.

1
4

- (iii) If we agree that the assistant was correct to record \$58,000 as a non-current asset, the only question is whether it should be regarded as impaired. An impairment has occurred **when the recoverable amount of an asset falls below its carrying amount**.

1

The projected results for this contract are:

	\$
Revenue (50,000 × 3)	150,000
Costs (bal)	(110,000)
Profit	<u>40,000</u>

1
1 + 1
4

If we ignore discounting, the **future cash flows** are \$150,000, less remaining costs of \$52,000 (\$110,000 – \$58,000), which amounts to \$98,000. This is well in excess of the \$58,000 carrying amount, so **no impairment has taken place** and the non-current asset should remain at \$58,000.

- (iv) *Government licence*

IAS 38 states that assets acquired as a result of a government grant may be **capitalised at fair value**, along with a **corresponding credit** for the value of the grant.

1 + 1

Therefore Darby may recognise an asset and grant of \$10m which are then **amortised/released** over the five year life of the licence. The net effect on profits and on shareholders' funds will be nil.

1
3

- (v) *Training costs*

Although well trained staff add value to a business, IAS 38 prohibits the **capitalisation of training costs**. The assistant should have treated these costs as an expense.

1

This is because an entity has **'insufficient control over the expected future economic benefits' arising from staff training**; in other words trained staff are free to leave and work for someone else. Training is part of the general cost of developing a business as a whole.

1
2
20



17 Lambda 2 (6/11)

Top tips. This question should be quite straightforward. Part (a) was a test of knowledge. You should be comfortable with IAS 38, as it is a relatively uncomplicated standard. Look to score at least 5 marks here.

Part (b) was again not difficult. The clues were in the scenarios for parts (i) and (ii). Part (iii) was a little trickier; the key was to realise that the licence would be amortised before being reviewed for impairment. Although IAS 36 can be a difficult standard, this was not a difficult aspect of it – all you needed to know was the logical relationship between carrying amount, and recoverable amount/value in use.

Easy marks. Most of the marks in part (a) should be easy!

[References: IAS 38: paras. 8–24, 42]

Marking scheme

		Marks
(a)	(i) An intangible asset is an identifiable non-monetary asset without a physical substance . It must be controlled as a result of a past event, and future economic benefits must be expected to flow from it.	$\frac{1}{2} + \frac{1}{2} + \frac{1}{2}$
	(ii) Identifiable	
	The asset must be identifiable in order to distinguish it from goodwill . This may mean it having been purchased, or it being separable such that eg it could be sold to another entity (eg development costs).	1
	Control	
	The asset must be controlled by the entity, eg through a legal right of ownership, so that it is the entity that will receive economic benefits from it . This disqualifies costs such as staff training costs, as there is no legal right of control over the staff, who may terminate their employment.	1
	Expected future benefits	
	It must be probable that future economic benefits will flow to the entity from the asset.	1
	Cost measured reliably	
	The cost of the asset will usually be the price paid for it (if purchased), or the costs spent developing it from which future benefits can be expected to flow. If the asset is acquired as part of a business combination, then the asset is measured at its fair value , provided that this can be measured reliably.	$\frac{1}{2} + \frac{1}{2} + \frac{1}{2} + \frac{1}{2}$
	(iii) Subsequent measurement is according to one of two models.	
	Under the cost model , the asset is measured at cost less accumulated amortisation, if it has a finite useful life. If its useful life is not finite then impairment reviews are conducted annually.	$\frac{1}{2} + \frac{1}{2}$
	Under the revaluation model , measurement is at the fair value of the asset. This model can only be applied if there is an active market , which for most intangible assets will not be the case. The asset must be revalued with sufficient regularity that its carrying amount does not differ significantly from its fair value at the end of the reporting period. Any gains are held as a revaluation surplus and are disclosed within other comprehensive income. Revaluation losses are charged first against any pre-existing surpluses, and then against profit or loss.	$\frac{1}{2} + \frac{1}{2} + \frac{1}{2}$
		<u>9</u>

		Marks						
(b)	(i) Costs are capitalised from 30 June 20X8 onwards (when commercial feasibility and technical viability were demonstrated). Hence the \$3.5m incurred before this point is expensed .	1 + 1						
	The \$3m incurred from 1 July to 31 December 20X8 is capitalised.	1						
	Amortisation is charged over the ten-year useful life, giving an annual charge of \$300,000.							
	Amortisation is charged from when the process begins to be exploited commercially; here this is 1 January 20X9 . Amortisation charged in the year ended 20X9 is $\$300,000 \times 3/12 = \$75,000$.	½						
	The carrying amount is thus:	½						
	<table><tr><td>Cost</td><td>3,000,000</td></tr><tr><td>Amortisation</td><td>(75,000)</td></tr><tr><td>Carrying amount</td><td>2,925,000</td></tr></table>	Cost	3,000,000	Amortisation	(75,000)	Carrying amount	2,925,000	
Cost	3,000,000							
Amortisation	(75,000)							
Carrying amount	2,925,000							
	(ii) The brand name is capitalised at its fair value of \$10m. It is amortised over its useful life of ten years , resulting in an expense of \$1m. The carrying amount at the year end is thus \$9m.	1 + 1						
	In accordance with IAS 38, no asset may be recognised in respect of the employees' expertise, as Lambda/Omicron does not exercise 'control' over them – they could leave their jobs. The amount will be recognised as part of any goodwill on acquisition of Omicron.	1 + 1						
	(iii) The licence is initially recognised at its cost of \$200,000. Its useful life is five years, so amortisation is charged of $\$200,000 \div 5 \times 6 \text{ months} = \$20,000$. The carrying amount is then \$180,000.	1½						
	The asset is then reviewed for impairment. It is impaired if its carrying amount is higher than its recoverable amount. This is the higher of value in use (\$185,000) and fair value less costs to sell (\$175,000) – the higher being \$185,000. Since the carrying amount is lower than this, it is not impaired.	1½						
		<u>11</u>						
		<u>20</u>						

18 Myriad and Epsilon

[References: IFRS 3: paras. 37–38, 53; IAS 38: paras. 8, 21]

- (a) (i) The fundamental accounting concept of consistency dictates that similar items should be treated in a consistent manner in each accounting period and over time. Where a company changes its accounting policy it impairs the consistency and comparability of financial statements. Therefore a change should only occur if a new policy is preferable to the old policy in that it gives a more appropriate presentation of events or transactions. This normally occurs where there is a change in an accounting statute or an accounting standard. It sometimes occurs on the acquisition of a subsidiary, where the subsidiary's policy differs to that of the group. The adoption of an accounting policy for the first time, or when a company applies a policy to transactions that differ substantially from any of its previous transactions, does not constitute a change of accounting policy.

(ii) STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME: YEAR TO:

	30 September 20X3	30 September 20X2 (restated)
	\$'000	\$'000
Amortisation $(1,060 \times 25\%)/(1,060 - 400) \times 25\%$	265	165

STATEMENT OF FINANCIAL POSITION

Intangible non-current assets		
Development expenditure – cost	1,230	(1,230 – 560) 670
– amortisation (see below)	(505)	(240)
– carrying amount	<u>725</u>	<u>430</u>
Retained earnings 1 October 20X2 (say)		1,000
Prior period adjustment (see below)		<u>345</u>
Retained earnings at 1 October 20X2 as restated		<u>1,345</u>

Working

	\$'000
Amortisation as at 30 September 20X2	
– eligible re 20X1 $300 \times 25\% \times 2$ years	150
– eligible re 20X2 $360 \times 25\% \times 1$ year	<u>90</u>
	240
Amortisation as at 30 September 20X3	
– eligible re 20X1 $300 \times 25\% \times 3$ years	225
– eligible re 20X2 $360 \times 25\% \times 2$ years	180
– eligible re 20X3 $400 \times 25\% \times 1$ year	<u>100</u>
	<u>505</u>

Prior period adjustment

The amount of the prior period adjustment would be the carrying amount of the development expenditure of \$345,000 ($420,000 - 75,000$) that would have been included in the statement of financial position at 30 September 20X1. The \$420,000 is the recognised amount of development costs, and the \$75,000 is one year's amortisation of the qualifying amount ie $\$300,000 \times 25\%$.

(b) Costs relating to acquisition

	\$m	\$m
Market value of shares issued in Epsilon (W1)		1,500
Contingent consideration at present value (W2)		<u>100</u>
Total cost of acquisition		1,600
Less: fair value of identifiable net assets acquired		
per Kappa's statement of financial position	1,200	
fair value of customer relationships	<u>100</u>	
		(1,300)
Goodwill on acquisition		<u>300</u>

Explanatory notes

Costs relating to acquisition

Under IFRS 3 *Business Combinations* the cost of acquiring Kappa is the aggregate of the fair value of the equity shares of Epsilon. Costs of acquisition such as legal and professional fees are expensed through profit or loss in accordance with IFRS 3 *Business Combinations*.

The only exception to this rule is the issue cost of shares which are dealt with in accordance with IAS 32. The issue cost of shares is not part of the business combination. In accordance with IAS 32 such costs reduce the proceeds from the equity issue.

Any additional costs of the business combination that are contingent on future events should be included at their fair value in the cost of the combination at the acquisition date. The present value of future cash flows should be measured where the effect of discounting is material.

Fair value of identifiable net assets acquired

Under IAS 38 *Intangible Assets* intangible assets can be recognised if they are identifiable, can be measured reliably and are under the control of the acquiring entity. Customer relationships fulfil these criteria, but employee relationships do not fulfil the control criteria.

Workings

- 1 *Market value of shares issued*

$$3/2 \times 100\text{m} \times \$10 = \$1,500\text{m}$$

- 2 *Present value of contingent consideration*

$$100\text{m} \times \$1.21 = 121\text{m}$$

$$\text{Discounted } \$121\text{m} \times 1/1.10^2 = \$100\text{m}$$

19 Worldwide Nuclear Fuels

[References: IAS 16: para. 16; IAS 37: paras. 10, 14, 63–65]

- (a) (i) Need for guidance on accounting for provisions

The IASB is keen to ensure that **only liabilities** as **defined** in its *Conceptual Framework* **appear on the statement of financial position**.

Provisions are 'liabilities of uncertain timing or amount' and in particular the IASB wishes to **prevent companies providing for future operating losses**. Provisions can be difficult to differentiate from liabilities and reclassification is common with the passage of time and clarification of events. Provisions are often subject to disclosures which do not apply to other payables, eg movements on provisions during a year. Many companies pay little regard to disclosures by utilising a heading 'other provisions'.

Once a provision has been set up, it becomes possible to charge expenses directly to it and so bypass the statement of profit or loss. Companies have engaged in **creative accounting devices** by setting up **large provisions** and subsequently releasing them back to the statement of profit or loss; provisions then became '**income smoothing**' devices.

There is concern over the ways in which provisions have been recognised. In many cases provisions have been **set up where there is no obligation** and in **other cases** companies have **failed to set up provisions where obligations do exist**. So there is scope for income and profit smoothing and **inconsistent reporting between companies**.

Users expect that a provision is recognised and measured on a consistent basis and disclosure occurs of the details of the provision to understand its nature, timing and amount.

- (ii) **Criteria for recognising provisions**

Under IAS 37, provisions must be recognised in the following circumstances.

- (1) There is a **legal or constructive obligation** to transfer benefits as a result of past events.
- (2) It is probable an outflow of economic resources will be required to settle the obligation.
- (3) A reasonable estimate of the amount required to settle the obligation can be made.
- (4) If a company can avoid expenditure by its future action, no provision should be recognised.

Constructive obligations emerge when an entity is committed to certain expenditures because of a pattern of behaviour which the public at large would expect to continue. Any alternative course of action which would conceal the constructive obligation could be very onerous. (An example would be a practice of giving customer refunds to preserve goodwill, where there is no legal obligation to do so.)

A constructive obligation for restructuring only exists when the criteria in IAS 37 are satisfied.

If an entity has an onerous contract, the present obligation should be recognised and measured.

No provisions for future operating losses should be recognised.

IAS 37 therefore takes a **statement of financial position perspective** of provisions. It ensures that all **proper liabilities** exist, rather than recognising expenses in the statement of profit or loss.

(b) Assessment of accounting treatment

The company is building up the provision over the life of the asset using the 'units of production' method.

IAS 37 requires a provision to be the **best estimate** of the expenditure required to **settle the obligation** at the **end of the reporting period**. The provision should be capitalised as an **asset** if the expenditure provides access to **future economic benefits**; **otherwise** it should be immediately charged to the **statement of profit or loss**.

IAS 16 *Property, Plant and Equipment* caters for debits set up when assets are created as a result of provisions. Such assets are **written off over the life** of the facility and **normal impairment rules** will apply. The decommissioning costs of \$1,231m (undiscounted) not yet provided for will be included as a provision (at the discounted amount) in the statement of financial position and a corresponding asset created.

The discounting method used is inconsistent. IAS 37 suggests the use of a pre-tax rate reflecting current market assessments of the time value of money and risks. The **discount rate** should **not reflect risks** which have been **included by adjusting future cash flows**.

The company also makes reserve adjustments for changes in price levels. This adjustment comprises two elements chargeable to the statement of profit or loss, not reserves:

- (i) **Adjustments** to the provision caused by changes in **discount rates**
- (ii) An **interest element** representing the '**unwinding**' of the **discount**, which should be classified as part of interest expenses in the statement of profit or loss

Any subsequent change in the provision should be recognised in profit or loss for the year, but the company is treating the adjustment of \$27m as a movement on reserves.

20 Epsilon 7 (12/08) (amended)

Top tips. Section (a) was on IAS 37. As it was quite clear that a provision could be recognised in this case, there was only 1 mark available for saying this in the marking scheme. The rest of the marks were available for discussing which costs could be included in the provision. Section (b) on IAS 20 was a reasonable question, and you could have scored well just by discussing the prescribed treatments of the various parts of the grant.

Examining team's comments. This question required candidates to explain the financial reporting implications of two issues: (a) The closure of a business segment; (b) The receipt of three different types of government grant.

The answer to this question was very satisfactory on the whole and I was very pleased to note the improvement in standard compared with previous sittings. The only aspect on which I wish to specifically comment is that many candidates seem to confuse the issue of potentially reporting a closure as a discontinued operation and whether or not a provision should be made for the closure costs.

[References: IAS 20: para. 12; IAS 37: paras. 70–83]

Marking scheme

	Marks
<p>(a) In accordance with IAS 37 <i>Provisions, Contingent Liabilities and Contingent Assets</i> a restructuring provision can be made here. A detailed formal plan must be in place because by the end of the reporting period negotiations had already committed to sell the segment's assets and terminate its contracts. There is a valid expectation on the part of those affected because letters had been sent out (on 6 September) offering either relocation or voluntary redundancy.</p> <p>Per IAS 37 the provision should only include costs that are directly related to the restructuring and not the entity's continuing operations.</p>	1
<p>(i) Redundancy costs should be provided for. They are directly related to the restructuring and bear no relation to ongoing activities.</p>	1
<p>(ii) Although Epsilon is committed to paying \$8m into the pension plan, this is not provided for as part of the restructuring because it will be partially offset by the \$7m reduction in future actuarial liabilities. The one-off additional retirement benefit cost of \$1m is, however, brought into the financial statements for the year ending 30 September 20X8, but as an increase in the liability for retirement benefits.</p>	2
<p>(iii) Redeployment costs are specifically excluded by IAS 37 and should not be provided for.</p>	1
<p>(iv) The anticipated loss on the sale of plant is not covered by IAS 37 but by IFRS 5 <i>Non-current Assets Held for Sale and Discontinued Operations</i>. The plant is measured at the lower of carrying amount (\$11m) and fair value less costs to sell (\$2m), and would be shown in a separate line in the statement of financial position 'Non-current assets held for sale'. The impairment loss is recognised in the statement of profit or loss at 30 September 20X8.</p>	2
<p>(v) Operating losses are specifically excluded by IAS 37 and should not be provided for.</p>	1
<p>The total amount provided for would thus be \$30m + \$5.5m = \$35.5m.</p>	
<p>The fact that the directors had decided to close the business segment on 31 August does not of itself meet the conditions for recognising a provision.</p>	½
<p>The results of the business segment being closed do not need to be shown separately. It is not yet a discontinued operation as part of IFRS 5 because it has not yet been disposed of or classified as held for sale. It will, however, be one in the next financial year (ending 30 September 20X9). The segment would qualify as being 'abandoned' per IFRS 5, and would therefore be a continuing operation until its closure in the next financial year. The segment would continue to be subject to the requirements of IFRS 8 <i>Operating Segments</i> until it is discontinued.</p>	2½
	<u>11</u>



		Marks
(b)	The basic principle of IAS 20 <i>Accounting for Government Grants and Disclosure of Government Assistance</i> is that grants should be recognised as income in whichever periods the costs they are intended to compensate occur.	1
(i)	There are no conditions attached to the \$6m, so there are no costs to match the money to. Hence the \$6m should be recognised as income straight away.	1
(ii)	The \$15m relates to the costs of the factory and should be matched to them. The costs occur over the 40 year useful life, and IAS 20 allows the grant to be matched to them in two ways: The grant could be used to reduce the cost of the asset and subsequent depreciation charges. The cost would have been \$60m with \$0.5m depreciation (= $\$60\text{m}/40 \text{ years} \times 4/12 \text{ months}$), but this would be reduced by the grant to \$45m cost less \$0.375m depreciation (= $\$45\text{m}/40 \text{ years} \times 4/12 \text{ months}$) to a carrying amount of \$44.625m. The other treatment would be to show the grant separately as deferred income, matching the income to the depreciation of the factory. The factory would remain at \$60m cost with \$0.5m depreciation. Income of \$0.125m (= $\$15\text{m}/40 \text{ years} \times 4/12 \text{ months}$) would be recognised in the statement of profit or loss, with the remaining \$14.875m being shown as deferred in the statement of financial position. Of this, \$0.375m would be shown within current liabilities as it would be released during the next year (= $\$15\text{m}/40 \text{ years}$), and the remaining \$14.5m (= $\$14.875\text{m} - \0.375m) would be in non-current liabilities.	1 2 2
(iii)	The question here is how likely it is that the grant will have to be repaid. In this case, it is possible but unlikely, so no liability needs to be recognised for it being repaid. The grant should therefore be treated as deferred income over the five years, of which \$0.6m (= $\$9\text{m}/5 \text{ years} \times 4/12 \text{ months}$) is recognised as income this year. The doubt over possible repayment of the grant in future should then be disclosed as a contingent liability in line with IAS 37, as repayment is possible but not probable. If it had been probable that the \$9m would have to be repaid, then no income would have been recognised in the statement of profit or loss and the full amount would be shown as a separate liability in the statement of financial position, reducing the amount of deferred income. If there was not enough deferred income to make up the amount of the liability (eg if some had already been recognised in the statement of profit or loss), then the deficit should be charged to the statement of profit or loss as an expense.	1 1
		<u>9</u> <u>20</u>

21 Delta 2 (6/12) (amended)

Top tips. This question presented you with four issues, covering different syllabus topics, and so is a good practice question. Remember to show your workings clearly and to give explanations.

In **part (a)** the provision for restoration at the end of its useful life should be capitalised, but note that the provision damage already caused by the end of the reporting period should be charged to profit or loss. In **part (b)** the cost is measured using the fair value of the options at the grant date.

Easy marks. **Part (d)**, as long as you note that the damage was caused after the end of the reporting period and remember that this is a non-adjusting event, you should be able to answer this question well.

Examining team's comments.

In **part (a)** the calculations of depreciation and unwinding the discount were poor.

The answers to **part (b)** were generally good, but the explanations of the computations generally unsatisfactory.

Most candidates showed good knowledge of the existence of a liability and contingent asset in **part (c)**, though coming up with an appropriate provision was a common failure.

Part (d) was generally well answered but some candidates failed to appreciate that it was an event after the end of the reporting period and stated that it was an adjusting event.

[References: IFRS 2: paras. 2, 7–8, 14; IAS 37: paras. 10, 14, 17, 34; IAS 16: para. 16]

Marking scheme

	Marks
(a) Under the principles of IAS 16 <i>Property, Plant and Equipment</i> costs of \$13.5m (\$10m + \$3.5m) will be debited to property, plant and equipment in respect of the cost of acquiring the extraction facility.	½
The costs of erecting the extraction facility (excluding the land) will be depreciated over a ten-year period, giving a charge in the current period of \$175,000 (\$3.5m × 1/10 × 6/12).	1
From 1 October 20X1, an obligation exists to rectify the damage caused by the erection of the extraction facility and this obligation should be provided for.	½
The amount provided is the present value of the expected future payment, which is \$966,000 (\$3m × 0.322).	1
The amount provided is debited to property, plant and equipment and credited to provisions at 1 October 20X1.	½
The debit to property, plant and equipment creates additional depreciation of \$48,300 in the current year (\$966,000 × 1/10 × 6/12).	1
The closing balance in property, plant and equipment is \$14,242,700 (\$13.5m – \$175,000 + \$966,000 – \$48,300).	½
As the date of settlement of the liability draws closer the discount unwinds.	½
The unwinding of the discount in the current year is \$57,960 (\$966,000 × 12% × 6/12).	1
The extraction process itself creates an additional liability based on the damage caused by the end of the reporting period.	½
The additional amount provided is \$34,100 (\$200,000 × 6/12 × 0.341).	1
This additional provision causes an extra charge to the statement of profit or loss and other comprehensive income.	½
The carrying amount of the provision at the year end is \$1,058,060 (\$966,000 + \$57,960 + \$34,100).	½
	<u>9</u>

	Marks
(b) Under the principles of IFRS 2 <i>Share-based Payment</i> this arrangement will be regarded as an equity settled share based payment.	½
The fair value of the equity settled share based payment will be credited to equity and debited to expenses (or occasionally included in the carrying amount of another asset) over the vesting period.	1
Where the transaction is with employees, fair value is measured as the market value of the equity instrument at the grant date.	½
The vesting condition relating to the number of executives who remain with Delta is a non-market condition so it is taken into account when estimating the number of options that will vest.	½
The vesting condition relating to the share price is a market condition so it is taken into account when measuring the fair value of an option at grant date.	½
Therefore the total estimated fair value of the share based payment is \$1,545,600 ($92 \times 20,000 \times \0.84).	1
1/3 of this amount (\$515,200) is recognised in the year ended 31 March 20X2.	½
\$515,200 is credited to equity and debited to expenses (or occasionally included in the carrying amount of another asset).	½
	<u>5</u>
(c) Under the principles of IAS 37 <i>Provisions, Contingent Liabilities and Contingent Assets</i> a provision should be made for the probable damages payable to the customer.	½
The amount provided should be the amount Delta would rationally pay to settle the obligation at the end of the reporting period. Ignoring discounting, this is \$1m.	½
This amount should be credited to liabilities and debited to profit or loss.	½
Under the principles of IAS 37 the potential amount receivable from the supplier is a contingent asset.	½
Contingent assets should not be recognised but should be disclosed where there is a probable future receipt of economic benefits – this is the case for the \$800,000 potentially receivable from the supplier.	1
	<u>3</u>
(d) The event causing the damage to the inventory occurred after the end of the reporting period.	½
Under the principles of IAS 10 <i>Events After the Reporting Period</i> this is a non-adjusting event as it does not affect conditions at the end of the reporting period.	1½
Non-adjusting events are not recognised in the financial statements, but are disclosed where their effect is material.	1
	<u>3</u>
	<u>20</u>

22 Kappa 4 (6/09)

Top tips. Employee benefits (IAS 19) is a difficult area of the syllabus, but this was a standard question and was very similar to questions the examining team have set on this area in the past. As long as you had revised the area properly, you should have been able to score well as there are a surprising amount of marks available for doing relatively little. Part (a) was very simple and you should have been looking for close to full marks in this part. Part (b) offered a lot of marks for what is essentially only the low-level skill of recalling information. The preparation requirement in (c) was relatively straightforward. With questions in this area you need to take care that you are using the right figures from the question, eg the correct discount rate.

Examining team's comments. This question required candidates to explain key requirements of IAS 19 *Employee Benefits* and apply them to a given scenario. The majority of candidates attempting this question showed a pleasing knowledge of the subject matter and scored high marks. A minority of candidates who attempted the question seemed to have little or no knowledge of the subject matter and scored very few marks – indicating that perhaps this question proved popular with very weak candidates.

[References: IAS 19: paras. 8, 51–52, 63–86]

- (a) Post-employment benefits are employee benefits (other than termination benefits) that are **payable after the completion of employment**.

Contributions to a defined contribution plan should be **recognised as an expense** in the period in which they are payable (except where the correct treatment of the relevant labour costs is to capitalise them). They are recognised in profit or loss for the year. The expense is measured as the amount paid into the plan during the period. As with any other expense, an accrual should be made for any contributions unpaid at the period end. Any excess contributions should be recognised as prepaid expenses.

In the event that **contributions are to be paid after 12 months** after the end of the period in which the employee performed the related service, the **payments should be discounted** in calculating the liability at the end of the reporting period.

- (b) An employer's **statement of financial position** should show the **liability or the asset relating to the defined benefit plan**. Since the plan will make the future payments (to the employees) from its own funds, the employer recognises a liability (or an asset) to the extent to which it will have to pay more into the plan for the plan to be able to make those payments. This is calculated as the difference between the fair value of the plan's assets and the present value of the liability to the employees.

This liability (or asset) would then be **adjusted for any remeasurements by the actuary**, as well as for any future payments to be made that relate to past service costs that have not been recognised yet, ie employment in prior periods.

If there is an asset in relation to the plan, this should then be measured as the lower of the figure just calculated, and the total of the present values of any unrecognised actuarial losses and past service costs, any refunds expected from the plan and any reduction to future contributions to the plan that are possible because of the surplus.

The **statement of profit or loss and other comprehensive income** would recognise, in profit or loss for the year, expenses for:

- The current service cost
- Net interest on the net defined benefit asset or obligation
- Past service costs
- The effect of any curtailments or settlements

Gains or losses on remeasurement of the net asset or liability would be recognised within other comprehensive income.

(c)

STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME – EXTRACTS

	\$'000
Current service cost	(6,000)
Interest cost (Note)	(300)
Amount recognised in profit/(loss)	(6,300)
Other comprehensive income:	
Remeasurement gains/losses (= 200 – 1,700)	(1,500)
Amount recognised in comprehensive income (total)	<u>(7,800)</u>

STATEMENT OF FINANCIAL POSITION – EXTRACTS

Fair value of plan assets	31,000
Net present value of defined benefit obligation	<u>(36,000)</u>
Closing net liability	<u>(5,000)</u>

RECONCILIATION OF MOVEMENT IN NET LIABILITY

Opening net assets (30 – 33)	(3,000)
Expense recognised in profit or loss and OCI	(7,800)
Contributions	<u>5,800</u>
Closing net assets (31 – 36)	<u>(5,000)</u>

*Notes to the financial statements – extracts**Changes in the present value of defined benefit obligation*

Opening defined benefit obligation	33,000
Interest cost (10%)	3,300
Current service cost	6,000
Benefits paid by plan	(8,000)
Loss on remeasurement to OCI (balancing figure)	<u>1,700</u>
Closing defined benefit obligation – per actuary	36,000

Changes in the fair value of plan assets

Opening fair value of plan assets	30,000
Expected return on assets (10%)	3,000
Contributions paid into plan	5,800
Benefits paid by plan	(8,000)
Gain on remeasurement to OCI (balancing figure)	<u>200</u>
Closing fair value of plan assets – per actuary	31,000

23 Omicron 2 (12/11)

Top tips. IAS 19 has a reputation for being one of the harder parts of the syllabus, but questions one should not be taxing once you have practised the area sufficiently. Part (a)(i) was straightforward, and you should be looking to get all three marks here. Part (a)(ii) was also not difficult, and two out of three marks here was eminently attainable. These are not areas on which you should be struggling. Part (a)(iii) is something that you should really know, and at the very least you could have gained one mark for stating the method that you use here.

Easy marks. Part (a)(i) was especially easy.

Examining team's comments.*Part (a)**Areas showing good knowledge:*

- The majority of candidates correctly compared and contrasted the key features of the two types of scheme.

Areas where mistakes were common:

- Some candidates seemed unclear on the differing accounting treatments and often seemed to confuse them. A particularly common error was to state that contributions under a defined benefits scheme were treated as an expense by the employer.

*Part (b)**Areas showing good knowledge:*

- Most candidates seemed to be aware that the net pension liability appeared in the statement of financial position and that the amounts included in the statement of profit or loss were the actuarially determined amounts.

Areas where mistakes were common:

- Showing the closing liability in liabilities and the asset under assets instead of netting them off.
- Calculating the service charge and the interest earned on the closing balances instead of the opening ones.
- Not explaining clearly where in the statement of financial position and statement of profit or loss the various amounts should be included. For example, not specifying that the net liability was a non-current one and whether or not the expenses were operating or financial expenses.

[References: IAS 19: paras. 8, 51–52, 63–86]

- (a) (i) A defined contribution plan is one where the value of the retirement benefits paid out (ie pensions) depends on the value of the plan, which is itself dependent on the value of contributions made. The party who makes contributions and receives benefits bears the risk here, since if the value of the plan falls then so do the benefits paid out.

In a defined benefit plan, by contrast, the value of retirement benefits paid out is defined in advance, and is not affected by the value of the plan. The risk here is with the plan operator because if the plan does not have sufficient funds to pay out the defined benefits then these must be made up.

- (ii) Payments into defined contribution plans are expenses in the year of employment, and are accounted for in the same way as eg salaries.

Defined benefit plans require an entity to set up a separate plan, to which it will usually have a liability in its financial statements. Employees' contributions are paid into the plan, and therefore reduce this liability. It is up to the entity to ensure that the plan has sufficient assets to be able to pay its future benefits.

- (iii) Remeasurements (actuarial gains and losses) must be recognised immediately or within other comprehensive income. This represents a change from the previous treatment, which allowed a choice of methods for recognition of remeasurements.

(b)

STATEMENT OF FINANCIAL POSITION – NON-CURRENT LIABILITIES	
Benefit obligation	\$'000
	41,500
Plan asset	(32,500)
	<u>9,000</u>
STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME	
<i>Operating expenses</i>	
Current service cost	(4,000)
<i>Finance costs</i>	
Interest cost (6% × \$35m)	(2,100)
Expected return on assets (5% × \$30m)	1,500
<i>Other comprehensive income</i>	
Actuarial losses	(2,600)

*Notes to the financial statements*1 *Reconciliation of movement in defined benefit obligation*

<i>Statement of financial position – non-current liabilities</i>	<i>\$'000</i>
Opening net liability	5,000
Expenditure (4,000 + 2,100)	6,100
Income (1,500 + 3,200)	(4,700)
Actuarial losses	2,600
Closing net liability	<u>9,000</u>

2 *NPV of benefit obligation*

	<i>\$'000</i>
At start of period	35,000
Current service cost	4,000
Interest cost	2,100
Benefits paid out	(2,000)
Actuarial loss (β)	2,400
	<u>41,500</u>

3 *Fair value of plan assets*

	<i>\$'000</i>
At start of period	30,000
Expected return on assets	1,500
Contributions received	3,200
Benefits paid out	(2,000)
Actuarial loss (β)	(200)
	<u>32,500</u>

24 Avco

[References: IAS 32: paras. 11, 17–27]

(a) **Classification differences between debt and equity**

It is not always easy to **distinguish between debt and equity in an entity's** statement of financial position, partly because many financial instruments have elements of both.

IAS 32 *Financial Instruments: Presentation* brings clarity and consistency to this matter, so that the **classification is based on principles** rather than driven by perceptions of users.

IAS 32 defines an **equity instrument** as: 'any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities'. It must first be **established that an instrument is not a financial liability**, before it can be classified as equity.

A key feature of the **IAS 32 definition of a financial liability** is that it is **a contractual obligation to deliver cash or another financial asset to another entity**. The contractual obligation may arise from a requirement to make payments of principal, interest or dividends. The contractual obligation may be explicit, but it may be implied indirectly in the terms of the contract. An example of a debt instrument is a bond which requires the issuer to make interest payments and redeem the bond for cash.

A financial instrument is an **equity instrument** only if there is no obligation to deliver cash or other financial assets to another entity and if the instrument will or may be settled in the issuer's own equity instruments. An example of an equity instrument is **ordinary shares, on which dividends are payable at the discretion of the issuer**. A less obvious example is preference shares required to be converted into a fixed number of ordinary shares on a fixed date or on the occurrence of an event which is certain to occur.

An instrument may be classified as an equity instrument if it contains a **contingent settlement provision** requiring settlement in cash or a variable number of the entity's own shares **only on the occurrence of an event which is very unlikely to occur** – such a provision is **not considered to be genuine**. If the **contingent payment condition is beyond the control of both the entity and the holder of the instrument**, then the instrument is classified as a **financial liability**.

A **contract resulting in the receipt or delivery of an entity's own shares is not automatically an equity instrument**. The classification depends on the so-called '**fixed test**' in IAS 32. A contract which will be settled by the entity receiving or delivering a **fixed number of its own equity instruments in exchange for a fixed amount of cash is an equity instrument**. The reasoning behind this is that by fixing upfront the number of shares to be received or delivered on settlement of the instrument in concern, the holder is exposed to the upside and downside risk of movements in the entity's share price.

In contrast, if the **amount of cash or own equity shares to be delivered or received is variable**, then the contract is a **financial liability or asset**. The reasoning behind this is that using a variable number of own equity instruments to settle a contract can be similar to using own shares as 'currency' to settle what in substance is a financial liability. Such a contract does not evidence a residual interest in the entity's net assets. Equity classification is therefore inappropriate.

IAS 32 gives two **examples** of contracts where the number of own equity instruments to be received or delivered varies so that their fair value equals the amount of the contractual right or obligation.

- (1) A contract to deliver a variable number of own equity instruments equal in value to a fixed monetary amount on the settlement date is classified as a financial liability.
- (2) A contract to deliver as many of the entity's own equity instruments as are equal in value to the value of 100 ounces of a commodity results in liability classification of the instrument.

There are **other factors** which might result in an instrument being **classified as debt**.

- (1) Dividends are non-discretionary.
- (2) Redemption is at the option of the instrument holder.
- (3) The instrument has a limited life.
- (4) Redemption is triggered by a future uncertain event which is beyond the control of both the issuer and the holder of the instrument.

Other factors which might result in an instrument being **classified as equity** include the following.

- (1) Dividends are discretionary.
 - (2) The shares are non-redeemable.
 - (3) There is no liquidation date.
- (b) (i) **Cavor**

B shares

The classification of Cavor's B shares will be made by applying **the principles-based definitions of equity and liability in IAS 32**, and considering the **substance**, rather than the legal form of the instrument. 'Substance' here relates only to consideration of the contractual terms of the instrument. Factors outside the contractual terms are not relevant to the classification. The following factors demonstrate that Cavor's B shares are **equity instruments**.

- (1) **Dividends are discretionary** in that they need only be paid if paid on the A shares, on which there is no obligation to pay dividends. Dividends on the B shares will be paid at the same rate as on the A shares, which will be variable.
- (2) Cavor has **no obligation to redeem** the B shares.

Share options

The 'fixed test' must be applied. If the amount of cash or own equity shares to be delivered is variable, then the contract is a debt instrument. Here, however, the contract is to be settled by Cavor issuing a fixed number of its own equity instruments for a fixed amount of cash. Accordingly there is **no variability, and the share options are classified as an equity instrument.**

(ii) **Lidan**

A financial liability under IAS 32 is a **contractual obligation to deliver cash or another financial asset to another entity.** The contractual obligation may arise from a requirement to make payments of principal, interest or dividends. The contractual obligation may be explicit, but it may be implied indirectly in the terms of the contract.

In the case of Lidan, the **contractual obligation is not explicit.** At first glance it looks as if Lidan has a choice as to how much it pays to redeem the B shares. However, the conditions of the financial instrument are such that the value of the **settlement in own shares is considerably greater than the cash settlement obligation.** The effect of this is that **Lidan is implicitly obliged to redeem the B shares at for a cash amount of \$1 per share.** The own-share settlement alternative is uneconomic in comparison to the cash settlement alternative, and cannot therefore serve as a means of avoiding classification as a liability.

IAS 32 states further that where a derivative contract has settlement options, **all of the settlement alternatives must result in it being classified as an equity instrument,** otherwise it is a financial asset or liability.

In conclusion, **Lidan's B shares must be classified as a liability.**

25 Seltec and Kappa

[References: IFRS 9: paras. 6.5.1–6.5.14; IAS 32: para. 12]

(a) **Financial instruments****Derivatives**

IAS 32 *Financial Instruments: Presentation* and IFRS 9 *Financial Instruments* define a **derivative** as a financial instrument or other contract that has all three of the following characteristics.

- (i) Its value changes in response to the change in a specified interest rate, financial instrument price, commodity price, foreign exchange rate, index of prices or rates, credit rating or credit index, or other variable (sometimes called the 'underlying').
- (ii) It requires no initial net investment or an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors.
- (iii) It is settled at a future date.

A contract is **not considered to be a derivative where its purpose is to take physical delivery** in the normal course of business, unless the entity has a practice of settling the contracts on a net basis.

In the case of Seltec, while the company often takes physical delivery of the edible oil, it does so only to sell shortly afterwards, and usually settles on a net basis. Thus the **contracts will be considered to be derivative** contracts rather than contracts for purchase of inventory. Derivatives are accounted for at fair value through profit or loss, unless hedge accounting applies.

Hedge accounting

The rules on hedge accounting are set out in IFRS 9 *Financial Instruments*. Before a hedging relationship qualifies for hedge accounting, **all** of the following **conditions** must be met.

- (i) The hedging relationship consists **only of eligible hedging instruments and eligible hedged items**.
- (ii) There must be **formal documentation** (including identification of the hedged item, the hedging instrument, the nature of the risk that is to be hedged and how the entity will assess the hedging instrument's effectiveness in offsetting the exposure to changes in the hedged item's fair value or cash flows attributable to the hedged risk).
- (iii) The hedging relationship meets all of the following hedge effectiveness criteria:
 - (1) There is an **economic relationship** between the hedged item and the hedging instrument, ie the hedging instrument and the hedged item have values that generally move in the opposite direction because of the same risk, which is the hedged risk;
 - (2) The **effect of credit risk does not dominate the value** changes that result from that economic relationship, ie the gain or loss from credit risk does not frustrate the effect of changes in the underlyings on the value of the hedging instrument or the hedged item, even if those changes were significant; and
 - (3) The **hedge ratio of the hedging relationship** (quantity of hedging instrument vs quantity of hedged item) is the same as that resulting from the quantity of the hedged item that the entity **actually hedges** and the quantity of the hedging instrument that the entity **actually uses** to hedge that quantity of hedged item.

A **fair value hedge** is a hedge of the exposure to changes in the fair value of a recognised asset or liability, or an identified portion of such an asset or liability, that is attributable to a particular risk and could affect profit or loss. The **gain or loss** resulting from **re-measuring** the hedging instrument at fair value is **recognised in profit or loss**. The gain or loss on the hedged item attributable to the **hedged risk** should **adjust the carrying amount** of the hedged item and be **recognised in profit or loss**.

- (b) Extracts from financial statements for year ended 30 September 20X7
Note. All numbers in \$'000.

Extract from the statement of financial position

Non-current liabilities:

Financial liability (W3)	5,993
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Equity

Option to acquire shares	443
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Extract from the statement of profit or loss

Finance cost	556
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Workings

1 *Split of financial instrument*

Under IAS 32 the initial carrying amount of the financial liability is the present value of the future cash outflows that would occur if the loan is repaid, discounted at 10%. This is $5,557 (120/(1.10) + 120/(1.10)^2 + 7,120/(1.10)^3)$ and the equity element is 443 ($6,000 - 5,557$). The financial liability is not held for trading and so is measured using amortised cost.

2 *Finance cost for the year to 30 September 20X7*

$$10\% \times 5,557 = 556$$

3 *Closing loan amount*

$$5,557 \times 1.1 - 2\% \times 6,000 = 5,993$$



26 Delta (12/12) (amended)

Top tips. Remember to show your workings clearly and to give explanations.

In **part (a)** the loan, a financial asset, is measured at amortised cost using the effective interest method, in accordance with IFRS 9. In **part (b)** the depreciation on the complex asset is calculated on the two identifiable components, the overhaul and the remainder.

Easy marks. **Part (b)**, as long as you note that there is a contingent liability and a contingent asset, you should be able to answer this question well.

Examining team's comments.

Part (a)

Areas showing good knowledge:

- Most candidates were aware that, whilst the financial asset had a zero coupon rate, the repayment premium meant that there was a finance cost associated with it due to the redemption premium.
- Most candidates were able to compute the finance cost using the effective rate of interest.

Areas where mistakes were common:

- Many candidates were not able to correctly deal with the issue costs of the loan asset. Some incorrectly stated that the costs should be recognised as an immediate expense, whilst others deducted the amount from the initial carrying value, rather than adding it on.
- Few candidates appreciated that the asset had suffered impairment in the current financial period. Where candidates did realise that this had occurred, some incorrectly stated that the loss would be recognised over the remaining term by reducing the effective rate of interest.

Part (b)

Areas showing good knowledge:

- Most candidates were aware that depreciation of this complex asset needed to be carried out in two parts.
- Basic depreciation calculations were generally of a satisfactory standard where candidates appreciated the 'complex asset' issue discussed above.

Areas where mistakes were common:

- A number of candidates who realised that the asset was complex added the \$4m overhaul cost to the \$20m total cost rather than treating it as a part of the \$20m overall cost.
- A number of candidates failed to appreciate that failure to depreciate an asset in a previous period is an accounting error that needs to be adjusted for retrospectively.

Part (c)

Areas showing good knowledge:

- Most candidates appreciated that the potential legal claim needed to be provided for as a liability.
- Most candidates realised that the potential re-imbursement was a contingent asset.

Areas where mistakes were common:

- A significant minority of candidates used expected values to compute the provision rather than the most likely outcome.
- A significant minority of candidates stated that the insurance claim should be recognised as an asset.
- A smaller minority of candidates stated that the legal claim should not be provided for, but disclosed.

[References: IFRS 9: paras. 4.1, 5.1–5.2, 5.5; IAS 8: paras. 41–42; IAS 37: paras. 10, 14, 31]

Marking scheme

	Marks
(a) The loan to the supplier would be regarded as a financial asset. The relevant accounting standard, IFRS 9, provides that financial assets are normally measured at fair value.	½
Where the financial asset is held within a business model where the only expected future cash inflows are the receipts of principal and interest and the investor intends to collect these contractual cash flows rather than dispose of the asset to a third party, then IFRS 9 allows the asset to be measured at amortised cost using the effective interest method.	½
Assuming this method is adopted, then the costs of issuing the loan are included in its initial carrying value rather than being taken to profit or loss as an immediate expense. This makes the initial carrying value \$2.1m.	1
Under the effective interest method, part of the finance income is recognised in the current period rather than all in the following period when repayment is due.	½
The income recognised in the current period is \$144,900 ($\$2.1\text{m} \times 6.9\%$).	1
In the absence of information regarding the financial difficulties of the supplier, the financial asset at 30 September 20X2 would have been \$2,244,900 ($\$2.1\text{m} + \$144,900$).	½
The information regarding financial difficulty of the supplier is objective evidence that the financial asset has suffered impairment at 30 September 20X2. This is then treated as a Stage 3 impairment loss.	½
Impairment is recognised as the present value of expected credit shortfalls over their remaining life (lifetime expected credit loss). Delta is required to reduce the gross carrying amount of the financial asset in the period in which it no longer has a reasonable expectation of recovery.	½
The asset is re-measured at the present value of the revised estimated future cash inflows, using the original effective interest rate. Under the revised estimates the closing carrying amount of the asset would be \$2,057,998 ($\$2.2\text{m}/1.069$).	1
The reduction in carrying value of \$186,902 ($\$2,244,900 - \$2,057,998$) would be charged to profit or loss in the current period as an impairment of a financial asset.	½
Therefore the net charge to profit or loss in respect of the current period would be \$42,002 ($\$186,902 - \$144,900$).	½
	<u>7</u>
(b) Omitting to charge depreciation where material would be regarded as an error under the principles outlined in IAS 8 <i>Accounting Policies, Accounting Estimates and Errors</i> .	½
Where an error has retrospective effect, it is adjusted as a movement on retained earnings in the statement of changes in equity rather than through profit or loss.	½
Because this is a complex asset, the depreciation charge is made on two identifiable components according to their fair values at the date of acquisition.	½
The first 'asset' is the overhaul element which would have a depreciable amount of \$4m.	½
The overhaul is not provided for as it is not certain that this will arise and hence the life of the first 'asset' is four years.	½
The depreciation charged on this 'asset' would be \$1m each year.	½
The second 'asset' is the remainder, to which the estimated residual value is allocated entirely.	½
The residual value is an accounting estimate which should be revised at the end of each accounting period.	½

	Marks
Therefore the depreciable amount for the year ended 30 September 20X1 is \$14.9m (\$20m – \$4m – \$1.1m)	1
This means that the depreciation on this 'asset' for the year ended 30 September 20X1 is \$1,862,500 (\$14.9m × 1/8).	½
The depreciable amount of this 'asset' for the year ended 30 September 20X2 is \$12,937,500 (\$16m – \$1,862,500 – \$1,200,000).	1
Therefore the depreciation charge on this 'asset' for the year ended 30 September 20X2 is \$1,848,214 (\$12,937,500 × 1/7).	1
The total depreciation charged to profit or loss for the year ended 30 September 20X2 is therefore \$2,848,214 (\$1m + \$1,848,214).	½
	<u>8</u>
(c) It is necessary to consider the two parts of this issue separately.	½
The claim made by our customer needs to be recognised as a liability in the financial statements for the year ended 30 September 20X2.	½
IAS 37 <i>Provisions, Contingent Liabilities and Contingent Assets</i> states that a provision should be made when, at the reporting date:	
<ul style="list-style-type: none"> • An entity has a present obligation arising out of a past event • There is a probable outflow of economic benefits • A reliable estimate can be made of the outflow 	½
All three of those conditions are satisfied here, and so a provision is appropriate.	
The provision should be measured as the amount the entity would rationally pay to settle the obligation at the reporting date.	½
Where there is a range of possible outcomes, the individual most likely outcome is often the most appropriate measure to use.	½
In this case a provision of \$1.6m seems appropriate, with a corresponding charge to profit or loss.	½
The insurance claim against our supplier is a contingent asset.	½
IAS 37 states that contingent assets should not be recognised until their realisation is virtually certain, but should be disclosed where their realisation is probable. This appears to be the situation we are in here.	½
Therefore the contingent asset would be disclosed in the 20X2 financial statements. Any credit to profit or loss arises when the claim is settled.	1
	<u>5</u>
	<u>20</u>

27 Ontario (6/16)

Top tips. This was a typical discursive question, requiring you to explain three different issues to a non-accountant. Part (a) (probably the most difficult of the three) concerned impairment of assets under IFRS 9. This is the first time the impairment of assets under IFRS 9 has been tested in DipIFR since the revision of IFRS 9 in 2014. As per the examiner's comments, students can have a reasonable expectation that new standards and amendments to existing standards will be examined soon after they become examinable.

Part (b) asked you to explain what biological assets are and how they are accounted for. If you had revised IAS 41, this would have been a fairly straightforward requirement.

Part (c) considered the requirements of IAS 8 and specifically the difference between an accounting policy and accounting estimate and the difference between prospective and retrospective adjustments. You should have been able to score quite a few marks on this part of the question – but remember to stick to what the question asks, don't discuss the correction of errors per IAS 8 as it hasn't been asked for.

Easy marks. There were plenty of easy marks available in parts (b) and (c) for stating the requirements of these standards in relation to the questions asked.

Examining team's comments. In part (a) candidates should depict the model of expected credit losses as was stated in newly amended IFRS 9 *Financial Instruments*. This topic is tested for the first time since it had been included into the DipIFR programme (December 2015). That is why there were reasonable expectations for this topic to appear in the exam. Unfortunately, not all candidates were aware of this model. Many candidates simply described three stages of impairment though in the standard there is no such structuring. In doing this they were demonstrating neither deep understanding, nor knowledge of accurate terminology.

It should be noted once again that answers that do not address the requirements of the question will not be awarded marks. In this particular case there was no need to waste time for definitions of financial instruments, classification of financial assets including criteria, business models for managing financial assets etc.

Part (b) was very popular and generally quite well answered.

Part (c). In general, many candidates scored well in this question. At the same time there were some candidates who did not provide the correct description of the meaning of the term 'retrospective'. The advanced candidates scored marks for mentioning that comparative figures were based on the new policy (rather than last year's actual figures) and that the opening balance of retained earnings was restated in the statement of changes in equity.

[References: IFRS 9: para. 5.5; IAS 8: paras. 5, 14–19, 32–37; IAS 41: paras. 5, 10]

Marking scheme

	Marks
Query One	
A financial asset is impaired when its carrying amount cannot be reasonably expected to be recovered through future generation of income or sale proceeds.	1
Note. Exact words not needed here, just the sense of the point.	
IFRS 9 <i>Financial Instruments</i> – classifies financial assets into three types. One of these types is 'fair value through profit and loss'. Where financial assets are measured on this basis, any impairment of the asset is automatically reflected in the measurement basis so no further action is required.	1
As far as other financial assets are concerned, the general rule is that we should recognise a loss allowance for 'expected credit losses'. The loss allowance should be recognised in profit or loss and deducted from the carrying amount of the financial asset in the statement of financial position.	$\frac{1}{2} + \frac{1}{2} + \frac{1}{2}$ $+ \frac{1}{2}$
A credit loss is the difference between the cash flows we are contractually entitled to receive in respect of a financial asset and the cash flows which are expected based on current circumstances.	1
Unless the credit risk attaching to the financial asset has increased significantly since initial recognition, the loss allowance should be based on expected credit losses in the next 12 months.	1



	Marks
Where the credit risk has increased significantly since initial recognition, the loss allowance should be based on lifetime expected credit losses.	1
As far as trade receivables are concerned, as a simplifying measure IFRS 9 allows the loss allowance to always be measured based on the lifetime expected credit losses.	$\frac{1}{8}$
Query Two	
A biological asset is defined in IAS 41 <i>Agriculture</i> as a living animal or plant. IAS 41 covers all biological assets, except for bearer plants. Bearer plants are plants that are solely used to grow produce over several periods and are not themselves consumed, such as apple trees or grape vines.	1
The majority of non-biological assets of an entity have an initial acquisition cost which can be computed with sufficient reliability to be used as its initial carrying value. For biological assets (eg a new born calf) this is often not the case.	1
Note. Exact words not needed here, just the sense of the point.	
For the vast majority of biological assets their initial measurement should be at its fair value less costs to sell . Gains or losses arising from such initial measurement should be recognised in profit or loss .	$\frac{1}{2} + \frac{1}{2} + \frac{1}{2}$
As the biological asset transforms and its fair value less costs to sell changes , the carrying amount of the asset should be updated with changes being recognised in profit or loss .	$\frac{1}{2} + \frac{1}{2} + \frac{1}{2}$
	<u>5</u>
Query Three	
IAS 8 <i>Accounting Policies, Changes in Accounting Estimates and Errors</i> defines an accounting policy as 'the specific principles, bases, conventions, rules and practices applied by an entity in preparing and presenting financial statements'.	1½
Note. Exact words not needed here, just the sense of the point.	
An example of an accounting policy would be the decision to apply the cost model or the fair value model when measuring investment properties.	1
Note. Any reasonable example accepted.	
When an entity changes an accounting policy, the change is applied retrospectively . This means that the comparative figures are based on the new policy (rather than last year's actual figures). The opening balance of retained earnings is restated in the statement of changes in equity .	$\frac{1}{2} + \frac{1}{2} + \frac{1}{2} + \frac{1}{2}$
Accounting estimates are made in order to implement accounting policies. An example of an accounting estimate would be (consistent with the above given example) the fair value of an investment property at the reporting date (where the fair value model was being applied).	1½
Note. Any reasonable example accepted.	
Changes in accounting estimates are made prospectively . This means applying the new estimates in future financial statement preparation , without amending any previously published amounts.	½
Note. Exact words not needed here, just the sense of the point.	
	$\frac{1}{2}$
	<u>7</u>
	<u>20</u>

28 Kappa (12/13)

Top tips. This question was on deferred tax. Part (a) might have confused you – the requirement to state how the tax base is computed could be read as asking for a discussion of tax rules which was clearly outside the scope of a DiplFR exam. What was actually being asked for is an explanation of some definitions from IAS 12 – the ACCA's answer follows the text of IAS 12 very closely. This was a difficult requirement, and it was important that you did not exceed your time limit when trying to answer it.

Part (b) should have been a bit better. It is important that your answers here are as specific as possible, for example in part (i) there is a half mark for stating that the deferred tax liability would be non-current. It is also important that you do not overlook the mention in the requirement of current tax, and that your answers make use of the official terminology of IAS 12 – terms such as 'taxable temporary difference'.

Easy marks. This was a difficult question, but the easy marks are for the calculations, which should have been within reach. The easiest of these is in calculating the final deferred tax asset or liability, using the tax rate of 25%.

Examining team's comments.

Part (a) – discussion of tax base and the IAS 12 recognition and disclosure requirements

Far too many candidates simply copied the information from the question and this, of course, gained no marks. Many gave very lengthy examples of where deferred tax may apply and again this did not answer the question. The better answers discussed the asset being deductible but did not go on to talk about the economic benefits and that if benefits are not taxable the tax base is the same as the carrying amount. For the liability the explanations were very vague. It seemed that many simply regurgitated the notes from the exam text and did not try and answer the question set.

Part (b) – application to three specific scenarios – revaluation of an investment, unrealised profit on an intra-group sale, revenue received in advance taxed on a receipts basis

Generally candidates focussed on the deferred tax issues and did not discuss the current tax ones. This lost about 1/3 of the marks for each section. Other candidates wasted time by lengthy discussions of the non-tax financial reporting implications of each transaction rather than focussing on the taxation aspects as required by the question.

[References: IAS 12: paras. 5, 15]

- (a) The tax base of an asset is the amount which will be **deductible** for tax purposes against any **taxable economic benefits** which will flow to the entity when the asset is recovered. If these benefits are **not taxable, the tax base equals the carrying amount.**

The tax base of a liability is its **carrying amount**, less any amount which will be **deductible for tax purposes** in respect of that liability in future periods. If the 'liability' is revenue received in advance, the tax base is its **carrying amount, less any revenue which will not be taxable in future periods.**

The general requirements of IAS 12 are that deferred tax liabilities should be recognised on all taxable temporary differences.

IAS 12 states that a deferred tax asset **should** be recognised for deductible temporary differences if it is **probable** that taxable profit will arise in future **against which the deductible temporary difference can be utilised.**

- (b) (i) Since the unrealised gain on revaluation of the equity investment is not taxable until sold, there are no current tax consequences.

Since the unrealised gain on revaluation of the equity investment is not taxable until sold, the tax base of the investment is \$200,000.

The revaluation creates a **taxable temporary difference of \$40,000** (\$240,000 – \$200,000).

This creates a deferred tax liability of **\$10,000** ($\$40,000 \times 25\%$). The liability would be non-current. The fact that there is no intention to dispose of the investment **does not affect the accounting treatment**.

Because the unrealised gain is reported in other comprehensive income, the related deferred tax expense is also reported in **other comprehensive income**.

- (ii) When Kappa sold the products to Omega, Kappa would have generated a taxable profit of **\$16,000** ($\$80,000 - \$64,000$). This would have created a current tax liability for Kappa and the group of **\$4,000** ($\$16,000 \times 25\%$). This liability would be shown as a **current** liability and charged as an expense in arriving at **profit or loss for the period**.

In the consolidated financial statements the carrying amount of the unsold inventory would be **\$38,400** ($\$64,000 \times 60\%$), with a tax base of **\$48,000** ($\$80,000 \times 60\%$).

In the consolidated financial statements there would be a **deductible** temporary difference of **\$9,600** ($\$38,400 - \$48,000$) and a potential deferred tax asset of **\$2,400** ($\$9,600 \times 25\%$). This **would be** recognised as a deferred tax asset, because Omega is expected to generate **sufficient taxable profits** against which to utilise the deductible temporary difference.

The deferred tax asset would be recognised as a current asset. The resulting credit would **reduce consolidated deferred tax expense** in arriving at profit or loss.

- (iii) The receipt of revenue in advance on 31 March 20X3 would create a **current** tax liability of **\$50,000** ($\$200,000 \times 25\%$) as at 30 September 20X3.

The carrying amount of the revenue received in advance at 30 September 20X3 is **\$80,000** ($\$200,000 - \$120,000$). Its tax base is nil ($\$80,000 - \$80,000$).

The deductible temporary difference of **\$80,000** would create a deferred tax **asset** of **\$20,000** ($\$80,000 \times 25\%$). The asset can be recognised because Kappa has **sufficient taxable profits** against which to utilise the deductible temporary difference. It would be recognised as a **current** asset since the remaining revenue is recognised in the next accounting period.

29 Epsilon (6/14)

Top tips. This was a fairly typical question about deferred tax (IAS 12): a written part asking you to explain the requirements of the standard and then a longer part asking you to apply the requirements to five different items. Deferred tax features fairly frequently in exams, not only in questions such as this, but also in group accounts questions, where consolidation adjustments often have deferred tax consequences.

Easy marks. Provided that you had revised this topic, there were easy marks available in part (a), particularly for explaining the definitions of tax bases and how temporary differences are identified.

Examining team's comments. Answers to this question were, on the whole, unsatisfactory. This could of course simply be due to the fact that deferred tax is a complex topic. However, it may also be due to the fact that candidates had endeavoured to 'question spot' (deferred tax was examined in December 2013). It is evident from the last two examination sittings that such a strategy is flawed and there is no reason why being examined in one sitting means that a topic cannot be examined in the next sitting. Quite apart from being an examinable issue in Section B questions, deferred tax adjustments also often feature in the consolidation that appears in question one.

[References: IAS 12: paras. 5, 15, 24–37]

- (a) (i) The tax base of an asset is the **tax deduction which will be available in future when the asset generates taxable economic benefits**. If the future economic benefits will **not be taxable**, the tax base of an asset is its carrying amount.
- The tax base of a liability is its carrying amount, less the tax deduction which will be available when the liability is settled. For revenue received in advance (or deferred income), the tax base is its carrying amount, less any amount of the revenue which will not be taxed in future periods.
- (ii) A **taxable temporary difference** arises when the carrying amount of an asset exceeds its tax base or the carrying amount of a liability is less than its tax base.
- A **deductible temporary difference** arises in the reverse circumstances (when the carrying amount of an asset is less than its tax base or the carrying amount of a liability is greater than its tax base).
- (iii) IAS 12 *Income Taxes* requires that (with specific exceptions) deferred tax liabilities are recognised on all taxable temporary differences.
- IAS 12 allows deferred tax assets to be recognised on deductible temporary differences **when future taxable profits are expected to be available** against which to offset the future tax deductions the deductible temporary differences are expected to generate.
- (b) (i) The tax loss creates a **potential deferred tax asset** for the Kappa group since its carrying amount is nil and its tax base is \$3m.
- However, **no deferred tax asset can be recognised** because there is no prospect of being able to reduce tax liabilities in the foreseeable future as no taxable profits are anticipated.
- (ii) The provision creates a **potential deferred tax asset** for the Kappa group since its carrying amount is \$2m and its tax base is nil.
- This deferred tax asset **can be recognised** because Kappa is expected to generate taxable profits in excess of \$2m in the year to 31 March 20X5.
- The amount of the deferred tax asset will be \$500,000 ($\$2\text{m} \times 25\%$).
- This asset will be presented as a **deduction from the deferred tax liabilities** caused by the (larger) taxable temporary differences.
- (iii) The development costs have a carrying amount of \$1.52m ($\$1.6\text{m} - (\$1.6\text{m} \times 1/5 \times 3/12)$).
- The tax base of the development costs is nil since the **relevant tax deduction has already been claimed**.
- The deferred tax liability will be \$380,000 ($\$1.52\text{m} \times 25\%$). All deferred tax liabilities are shown as **non-current**.
- (iv) **No deferred tax liability arises in respect of goodwill on consolidation** when it is created. This is a specific exception referred to in IAS 12.
- As a consequence of this, **no adjustment is made for deferred tax** purposes when goodwill is impaired. Therefore there are no deferred tax implications for the consolidated statement of financial position.
- (v) The carrying amount of the loan at 31 March 20X4 is \$10.78m ($\$10\text{m} - \$200,000 + (\$9.8\text{m} \times 10\%)$).
- The tax base of the loan is \$10m ($\$10.78\text{m} - (\$980,000 - \$200,000)$).
- This creates a **deductible temporary difference** of \$780,000 and a **potential deferred tax asset** of \$195,000 ($\$780,000 \times 25\%$).
- Due to the availability of taxable profits next year (see part (ii) above), this asset can be recognised as a **deduction from deferred tax liabilities**.

30 Edgworth (6/16)

Top tips. Deferred tax is examined frequently in DipIFR. If you struggled with this question, you should make sure you revise deferred tax in order to be fully prepared for your exam. Part (a) had some easy marks available for defining the tax base of an asset and liability as per IAS 12. You were then required to use those definitions to compute the tax bases of some assets and liabilities. Part (b) required the computation of the deferred tax liability and the charge/credit to profit or loss and to other comprehensive income.

Easy marks. A few easy marks were available for the definitions in part (a).

Examining team's comments. Despite this topic being frequently tested, candidates found it challenging.

In part (a) not all candidates correctly reproduced the definition. The tax base on the current assets was correctly stated as zero by many candidates though without any relevant explanations. Both questions (a)(i) and (a)(ii), 4 marks each, were challenging for candidates without in-depth knowledge of the core issues of deferred taxes. It is important to read the requirements of the question carefully to avoid producing non-relevant definitions of the temporary differences, taxable and tax deductible, and deferred tax assets/liabilities.

In part (b) all three cases dealt with deferred tax liabilities. Nevertheless, the vast majority of candidates who attempted this question focussed on explaining why there was a deferred tax liability as opposed to a deferred tax asset, and omitted to mention whether a charge or credit is made related to deferred tax. Again it is important to read and understand the requirements before starting an answer. Many candidates made the mistake of calculating deferred tax without using the balance sheet method. Many candidates calculated revaluation surplus and multiplied it by the tax rate. This does not comply with IAS 12 requirements even if correct figures were produced.

[References: IAS 12: paras. 5, 15, 24–37]

Marking scheme

		Marks
(a)	(i)	
	The tax base of an asset is the amount which will be deductible for tax purposes against any taxable economic benefits which will flow to the entity when it recovers the carrying amount of the asset. If those economic benefits will not be taxable, the tax base of the asset is equal to its carrying amount.	2
	Where an asset is purchased for \$250,000 and has already received a tax deduction of \$100,000, then the future tax deduction which is available will be \$150,000 (\$250,000 – \$100,000). The tax base of the asset is \$150,000.	1
	The interest receivable will generate a taxable economic benefit of \$60,000 when it is received in the following period. There is no related tax deduction against this taxable benefit so the tax base of this asset is nil.	<u>1</u>
		<u>4</u>
	Note. Exact wordings not required for marks.	
	(ii)	
	The tax base of a liability is its carrying amount, less any amount which will be deductible for tax purposes in respect of that liability in future periods. In the case of revenue which is received in advance, the tax base of the resulting liability is its carrying amount, less any amount of the revenue which will not be taxable in future periods.	2
	For a trade payable which relates to a purchase which has already been fully deducted for tax purposes, there will be no further deduction when the payable is settled. Therefore in this case the tax base of the liability is \$120,000.	1
	For an accrual of \$40,000 which relates to an expense which will qualify for a tax deduction only when the liability is settled, the tax base is nil (\$40,000 – \$40,000).	<u>1</u>
		<u>4</u>
	Note. Exact wordings not required for marks.	



Marks

(b) Deferred tax liability at 31 March 20X6

Component	Explanation/working	Amount \$'000	
Investment property	Carrying value is \$38 million. Tax base is \$30 million. Taxable temporary difference is \$8 million.	1,600	1½
Investment in Lowercroft	Carrying value is \$75 million. Tax base is \$45 million. Taxable temporary difference is \$30 million.	6,000	1½
Head office property	Carrying value is \$45 million. Tax base is \$20.75 million (\$22 million – \$1.25 million).	4,850	2
		<u>12,450</u>	

Deferred tax charge/(credit) to profit or loss for the year ended 31 March 20X6

Component	Explanation/working	Amount \$'000	
Investment property	Opening deferred tax liability is \$1 million (20% × {\$35 million – \$30 million}). Fair value changes are recognised in profit or loss. Tax charge is the difference between the closing and opening liability.	600	1½
Investment in Lowercroft	Opening deferred tax liability is \$5 million (20% × {\$70 million – \$45 million}). Share of profits under the equity method is recognised in profit or loss. Tax charge is the difference between the closing and opening liability.	1,000	1½
Head office property	See working below	(150)	2½
		<u>1,450</u>	

Deferred tax charge/(credit) to other comprehensive income for the year ended 31 March 20X6

Component	Explanation/working	Amount \$'000	
Head office property	See working below	1,400	1½
		<u>12</u>	
		<u>20</u>	

Working for deferred tax on property revaluation

The deferred tax liability at 31 March 20X5 is \$3.6 million (20% {\$40 million – \$22 million}).

At 31 March 20X6, prior to revaluation, the carrying amount of the property is \$38 million and its tax base is \$20.75 million (\$22 million – \$1.25 million). The deferred tax liability at this point is \$3,450,000 (20% × {\$38 million – \$20.75 million}).

The reduction in this liability is \$150,000 (\$3.6 million – \$3,450,000). This would be credited to income tax expense in arriving at profit or loss.

Following revaluation the carrying value becomes \$45 million and the tax base stays the same. So the new deferred tax liability is \$4,850,000 (20% × (\$45 million – \$20.75 million)).

The increase in the deferred tax liability of \$1,400,000 (\$4,850,000 – \$3,450,000) is debited to other comprehensive income.



31 Delta (6/13) (amended)

Top tips. The mixed standards question is frequently something of a mixed bag in terms of difficulty. In this case, parts (a) and (c) were harder than (b). That being said, however, part (a) should have been within your reach as there are many marks available for what is essentially just selecting the correct exchange rate, and then performing the calculation accordingly.

Part (b) contained marks for knowledge from IFRS 11, and then a fairly simple application of IAS 23.

Part (c) hinged on the IFRS 3 definition of control, so if you didn't score well here then it's not something you'll be likely to forget in the future!

Easy marks. There are easy marks for performing calculations in part (b).

Examining team's comments. Part (a) was answered poorly by a majority of candidates. Most were able to appreciate that the financial liability should be measured at amortised cost. However many appeared unsure about whether to apply this principle before translating into \$ (as they should have) or after. Consequently few candidates were able to correctly compute the finance cost or closing balance in \$ or the exchange difference on translation.

Answers to part (b) were generally of a higher standard than for question 2 (a). Most candidates were able to appreciate that the costs and assets of the joint arrangement were partly included in the financial statements of Delta and most made a reasonable attempt to capitalise the finance costs appropriately.

Part (c) was poorly answered. Very few candidates appreciated that Epsilon was a subsidiary of Delta due to the ability of Delta to control Epsilon. The focus for almost all candidates was whether the lease was operating or finance.

[References: IFRS 10: paras. 10–12; IFRS 11: para. 5, Appendix A; IAS 21: paras. 22–23; IAS 23: para. 26].

Marking Scheme

	Marks
(a) On initial recognition, the loan in € is €49m (€50m – €1m).	½
The finance cost in € is €4.9m (€49m × 10%).	½
The closing balance of the loan in € is €49.9m (€49m + €4.9m – €4m).	½
IAS 21 <i>The Effect of Changes in Foreign Exchange Rates</i> states that foreign currency transactions are initially recorded at the rate of exchange in force when the transaction was first recognised.	½
Hence the loan would initially be recorded at \$68.6m (€49m × 1.40).	½
The finance cost would be recorded at the average rate for the period, because it accrues over a period of time.	½
The finance cost would be \$6.958m (€4.9m × 1.42).	½
The actual payment of interest would be recorded at \$5.8m (€4m × 1.45).	½
The loan balance is a monetary item so it is translated at the rate of exchange at the end of the reporting period.	½
So the closing loan balance is \$72.355m (€49.9m × 1.45).	½
The exchange differences that are created by this treatment are recognised in profit or loss.	½
In this case, the exchange difference is ((€68.6m + €6.958m – €5.8m) – \$72.355m) = \$2.597m.	1
This exchange loss is taken to profit or loss.	½
	<u>7</u>

	Marks
(b) This is a joint arrangement in the terms of IFRS 11 <i>Joint Arrangements</i> , because two or more parties have joint control of the pipeline under a contractual arrangement.	1
This will be regarded as a joint operation because Delta and the other investor have rights to the assets and obligations for the liabilities of this joint arrangement.	1
This means that Delta and the other investor will each recognise 50% of the cost of constructing the asset in property, plant and equipment.	$\frac{1}{2}$
The borrowing cost incurred on constructing the pipeline should, under the principles of IAS 23 <i>Borrowing Costs</i> , be included as part of the cost of the asset for the period of construction.	$\frac{1}{2}$
In this case, the relevant borrowing cost to be included is \$500,000 ($\$10\text{m} \times 10\% \times 6/12$).	1
The total cost of the asset is \$40.5m ($\$40\text{m} + \$500,000$). \$20.25m is included in the property, plant and equipment of Delta and the same amount in the property, plant and equipment of the other investor.	1
The depreciation charge for the year ended 31 March 20X3 will therefore be \$1,012,500 ($\$40.5\text{m} \times 1/20 \times 6/12$). \$506,250 will be charged in the statement of profit or loss of Delta and the same amount in the statement of profit or loss of the other investor.	1
The other costs relating to the arrangement in the current year totalling \$900,000 (finance cost for the second half year of \$500,000 plus maintenance costs of \$400,000) will be charged to the statements of profit or loss of Delta and the other investor in equal proportions – \$450,000 each.	$\frac{1}{7}$
(c) Under the principles of IFRS 10 <i>Consolidated Financial Statements</i> Delta has control over Epsilon. This is because:	1
The purpose of setting up Epsilon is to enable Delta to achieve a specific purpose.	$\frac{1}{2}$
Epsilon's dependence on Delta indicates that Delta has effective power over Epsilon.	1
The directors of Delta are acting as <i>de facto</i> agents of Delta in terms of their shareholdings in Epsilon.	$\frac{1}{2}$
Delta is exposed to variable returns (on the leased asset) which Delta has the power to affect through its use.	1
Therefore Delta will consolidate Epsilon and Epsilon's right-of-use asset and associated lease liability will be included in the consolidated financial statements.	1
The rental payments between Delta and Epsilon and the right-of-use asset and associated lease liability for the lease of the asset from Epsilon to Delta will be eliminated as an intra-group transaction.	$\frac{1}{1}$
	<u>6</u>
	<u>20</u>

32 Omega (6/14)

Top tips. This question asks you to explain three accounting issues to a non-accountant. It is mainly discursive, but there are some marks available for calculations. Part (a) is about related party relationships and disclosures; it should be fairly clear that this is a related party relationship and should be disclosed, even though all the purchases are apparently at normal rates. Remember to explain **why** Sigma is now a related party of Omega and **what** must be disclosed. Notice that the question is **not** asking for a general discussion about related party transactions and why they must be disclosed.

Part (b) requires you to explain why advertising expenditure cannot be recognised as an intangible asset. Remember that the accruals concept applies here.

Part (c) concerns exchange differences and provided you had revised this area it should have been straightforward.

Easy marks. There were easy marks available for the simple calculations in parts (b) and (c).

Examining team's comments. On the whole the answers to this three-part analysis question were satisfactory. In **part (a)** a number of candidates incorrectly concluded that Sigma was a subsidiary of Omega and should therefore be consolidated, completely missing the related party issue. On the whole **part (b)** was well answered, with the vast majority of candidates appreciating that IAS 38 *Intangible Assets* effectively prohibits the capitalisation of advertising expenditure as an intangible asset. However, not all candidates appreciated that payments made for television advertisements not yet shown should be treated as pre-payments. Many good answers were also provided to **part (c)**. However, not all candidates appreciated that the purchased machine, being a non-monetary asset that is measured under the cost model, would continue to be reported using the rate of exchange in force at the date of acquisition.

[References: IAS 21: paras. 21–23; IAS 24: paras. 9, 13–24; IAS 38: paras. 8, 18, 29]

Marking scheme

	Marks
(a) From 1 January 20X4, Sigma would be regarded as a related party of Omega under IAS 24 <i>Related Party Disclosures</i> .	1
This is because Sigma is controlled by the close family member of one of Omega's key management personnel .	$\frac{1}{2} + \frac{1}{2} + \frac{1}{2}$
This means that, from 1 January 20X4 , the purchases from Sigma would be regarded as related party transactions .	1
Transactions with related parties need to be disclosed in the notes to the financial statements, together with the nature of the relationship . It is irrelevant whether or not these transactions are at normal market rates.	$\frac{1}{2} + \frac{1}{2} + \frac{1}{2}$
The disclosures would state that a company controlled by the spouse of a director supplied goods to the value of \$4.5m ($3 \times \1.5m) in the current accounting period. It would not be necessary to name the company.	$\frac{1 + 1}{7}$
(b) Under IAS 38 <i>Intangible Assets</i> intangible assets can only be recognised if they are identifiable and have a cost which can be reliably measured.	$\frac{1}{2} + \frac{1}{2} + \frac{1}{2}$
These criteria are very difficult to satisfy for internally developed intangibles.	$\frac{1}{2}$
For these reasons, IAS 38 specifically prohibits recognising advertising expenditure as an intangible asset.	1
The issue of how successful the store is likely to be does not affect this prohibition.	$\frac{1}{2}$



	Marks
Therefore your colleague is correct in principle that such costs should be recognised as expenses.	½
However, the costs would be recognised on an accruals basis.	½
Therefore, of the advertisements paid for before 31 March 20X4, \$700,000 would be recognised as an expense and \$100,000 as a pre-payment in the year ended 31 March 20X4.	1
The \$400,000 cost of advertisements paid for since 31 March 20X4 would be charged as expenses in the year ended 31 March 20X5.	½
	<u>6</u>
(c) Under the principles of IAS 21 <i>The Effects of Changes in Foreign Exchange Rates</i> the asset and liability would initially be recognised at the rate of exchange in force at the transaction date – 1 January 20X4. Therefore the amount initially recognised would be \$200,000 (2 million kroner × 1/10).	½ + ½ + ½
The liability is a monetary item so it is retranslated using the rate of exchange in force at 31 March 20X4 . This makes the closing liability \$250,000 (2 million kroner × 1/8).	½ + ½ + ½
The loss on re-translation of \$50,000 (\$250,000 – \$200,000) is recognised in the statement of profit or loss .	½ + ½
The machine is a non-monetary asset carried at historical cost . Therefore it continues to be translated using the rate of 10 kroner to \$1.	½ + ½ + ½
Depreciation of \$12,500 (\$200,000 × ¼ × 3/12) would be charged to profit or loss for the year ended 31 March 20X4.	½ + ½
The closing balance in property, plant and equipment would be \$187,500 (\$200,000 – \$12,500). This would be shown as a non-current asset in the statement of financial position.	½
	<u>7</u>
	<u>20</u>

33 Agriculture

[References: IAS 41: paras. 1, 5, 10–13, 26]

- (a) IAS 41 *Agriculture* prescribes the accounting treatment of agricultural activity. This relates to the transformation of biological assets (living animals and plants) into agricultural produce for sale or additional biological assets. Examples of biological assets are animals (livestock) such as sheep for wool and food production, or plants for crop such as cotton, sugar, tea, or timber (from forestry). Biological transformation occurs through natural growth, procreation (breeding), production (milk) or degeneration (age). These cause qualitative or quantitative changes in a biological asset. IAS 41 only applies to agricultural produce up to the point of harvest; thereafter the produce is accounted under IAS 2 *Inventory*.

IAS 41 requires that biological assets within its scope should be measured at fair value less estimated point-of-sale costs. Fair value should be determined by reference to the principal market for the asset. Gains or losses on initial recognition of a biological asset or changes in fair value less point-of-sale costs should be included in profit or loss for the period. The fair value model does not apply to agricultural land or intangible assets related to agricultural activity. These should continue to be accounted under IAS 16 *Property, Plant and Equipment* or IAS 40 *Investment Property*. Both of these standards allow the use of the cost based value or the current (fair value) model.

An amendment to IAS 41 requires that bearer plants (living plants that are used in the production or supply of agricultural produce, such as grape vines and rubber trees) should also be accounted for under IAS 16.

(b) ROTUNDA – STATEMENT OF PROFIT OR LOSS EXTRACTS YEAR TO 31 MAY 20X3

	\$
Fair value increase in wool sheep $(9,200 + 2,400 - 4,000)$	7,400
Fair value increase in the breeding sheep $(35,000 - 15,000)$	20,000
Fair value increase in forest $(500,000 - 480,000)$	20,000
Accrual of government grant	12,000

STATEMENT OF FINANCIAL POSITION EXTRACTS AT 31 MAY 20X3

	\$
Non-current assets	
Land at valuation	750,000
Forest	500,000
Animals (see reconciliation below)	487,400
	<u>1,737,400</u>
Current inventory	
Inventory of cut trees (Note 1)	250,000
Revaluation reserve (Note 2)	
Brought forward	225,000
Increase in year	25,000
Balance at 31 May 20X3	<u>250,000</u>

Reconciliation

	\$	\$
Fair value 1 June 20X2		
Wool sheep under 5 $(2,000 \times 100)$		200,000
Wool sheep over 5 $(1,000 \times 80)$		80,000
Lambing sheep under 6 $(1,500 \times 120)$		180,000
		<u>460,000</u>
Increase due to price change		
Wool sheep under 5 $(1,800 \text{ (Note 3)} \times (105 - 100))$		9,000
Wool sheep over 5 $(1,200 \times (82 - 80))$	2,400	
Lambing sheep under 6 $(1,500 \times (120 - 110))$	<u>(15,000)</u>	<u>(12,600)</u>
		(3,600)
Increase due to physical change		
Wool sheep under 5 becoming 5 (200×20)	(4,000)	
New born lambs $(1,250 \times 28)$	<u>35,000</u>	
		<u>31,000</u>
Fair value 31 May 20X3		
Wool sheep under 5 $(1,800 \times 105)$	189,000	
Wool sheep over 5 $(1,200 \times 82)$	98,400	
Lambing sheep under 6 $(1,500 \times 110)$	165,000	
New born lambs $(1,250 \times 28)$	<u>35,000</u>	
		<u>487,400</u>

Notes

- 1 IAS 41 says that after harvest inventories should be accounted for using IAS 2 *Inventories*. Under this standard the inventory is valued at the lower of cost or net realisable value, thus the increase in the fair value of the cut trees should not be recognised until they are sold.
- 2 Under the allowed alternative treatment in IAS 16 *Property, Plant and Equipment*, increases in the value of assets should go to revaluation reserve, not the statement of profit or loss.
- 3 As no wool sheep have been bought or sold, 200 sheep under 5 must have become over 5 during the year.



34 Omega 6 (12/09) (amended)

[References: IFRS 6: paras. 3, 8, 10, 12; IAS 37: paras. 70–83]

(a) STATEMENT OF FINANCIAL POSITION OF DOBUICHA FOR THE YEAR ENDED 30 SEPTEMBER 20X9

<i>Non-current assets</i>	\$
Exploration and evaluation assets	347,500

STATEMENT OF PROFIT OR LOSS OF DOBUICHA FOR THE YEAR ENDED 30 SEPTEMBER 20X9

Expenses	
Surveying (= $3/12 \times \$150,000$)	37,500
Drilling	25,000
General administrative overheads	25,000

IFRS 6 *Exploration for and Evaluation of Mineral Resources* applies to the period from when an entity has begun exploring an area up to when the extraction of resources from that area is both technically feasible and commercially viable.

Before exploration has begun, IFRS 6 does not prescribe any accounting treatment. In accordance with the *Conceptual Framework*, however, no asset can be recognised in this period as any expenditure would not result in an inflow of future economic benefits to the entity. Therefore any expenditure incurred before this date must be recognised as an expense in the statement of profit or loss.

Once the technical feasibility and commercial viability of the extraction of resources can be demonstrated, expenditure must be accounted for in accordance with IAS 38 *Intangible Assets*. This stage has not yet been reached by Dobuicha.

The legal right to explore was acquired on 1 January 20X9. Up until this point any expenditure incurred must be expensed; after this point, it will be capitalised in accordance with IFRS 6 and with Dobuicha's stated policy of capitalisation.

Surveying costs are expensed up until the legal right to explore is acquired on 1 January 20X9. Thus \$37,500 is expensed (= $3/12 \times \$150,000$), and \$112,500 (= $9/12 \times \$150,000$) is capitalised.

The drilling costs and sampling costs incurred after 1 January 20X9 are capitalised, and those incurred before that date are treated as an expense. All of the 'other costs' are capitalised.

General administrative overheads do not relate to the exploration and evaluation of resources, and must be expensed, therefore \$25,000 must be charged to profit or loss.

Finally, the costs incurred to acquire the legal right to explore the area are themselves capitalised.

The asset in the statement of financial position will therefore be measured as follows.

	\$
Surveying (= $9/12 \times \$150,000$)	112,500
Drilling costs	145,000
Sampling costs	15,000
Other costs	25,000
Legal costs	50,000
	<u>347,500</u>

(b) IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* states that a provision can be created for restructuring where the entity:

- Has a detailed formal plan
- Has raised a valid expectation in those affected that it will carry out the restructuring

Omega clearly has a detailed formal plan, and has publically announced its decision. A provision should therefore be created. The following amounts will be included in its statement of profit or loss for 20X9.

- (i) Redundancy costs are provided for as they are necessarily entailed by the restructuring and do not relate to Omega's ongoing activities. IAS 37 requires provisions to be measured at the best estimate of the expenditure required. This would qualify as an adjusting even in line with IAS 10 *Events After the Reporting Period*. Profit is therefore reduced by \$1.9m.
The \$800,000 required to retrain employees will not be provided for and will not affect profit, as it relates to Omega's ongoing activities.
- (ii) Although not part of the restructuring, plant equipment with a carrying amount of \$8m but a recoverable amount of \$1.5m are clearly impaired. IAS 36 *Impairment of Assets* requires that they be restated at recoverable amount of \$1.5m, resulting in the recognition of an impairment loss of \$6.5m in profit and loss.
- (iii) The statement of profit or loss will recognise an expense of \$550,000. In line with IAS 10, this would qualify as an adjusting even after the reporting period, which the financial statements should reflect.
- (iv) IAS 37 does not permit a provision to include amounts in respect of future operating losses, as they relate to the ongoing activities of the entity. There will be no charge to the statement of profit or loss in respect of these losses for the year ended 30 September 20X9. Provisions should only be made for events that took place in the past, whereas these expected losses take place in the future.

35 Omega (6/15)

Top tips. This question asks you to explain two accounting issues to a non-accountant and is entirely discursive. The first of these was IAS 41, one of the more peripheral areas of the syllabus. Its inclusion illustrates that you must be careful not to leave out anything in your revision. The second issue was the IFRS for SMEs. In both cases, only the main provisions were required. You should also note your audience, and try to avoid making your answer too technical.

Easy marks. Even a basic knowledge of the IFRS for SMEs could have scored a good mark in part (b).

Examining team's comments. This question was not answered well by the majority of candidates attempting it and indeed a reasonable number of candidates did not attempt it at all. As has already been noted in this report, this may be indicative of the fact that these subjects have been regarded as 'fringe' topics and not studied diligently by many candidates. It is very important for candidates to ensure that they have studied the whole of the syllabus.

Part (a) required candidates to explain the applicability of general international financial reporting standards (IFRS) to farming entities and also to outline the main recognition and measurement issues outlined in IAS 41. Candidates were specifically asked about the way government grants relating to agricultural activity need to be accounted for. A number of candidates incorrectly stated that other IFRS do not apply to farming entities. The majority of candidates incorrectly stated that government grants for agricultural activity are accounted for in the same way as other government grants. Most candidates did have some awareness of the concept of a biological asset, and the difficulty of applying the cost concept to the measurement of such an asset. However the general level of knowledge displayed in this part was rather disappointing.

Part (b) asked candidates to outline the main components of the IFRS for SMEs, and explain whether the IFRS for SMEs could be used by a small listed entity. Most candidates stated that the small entity in question could use the IFRS for SMEs, despite the fact that the IFRS for SMEs cannot be used by listed entities, whatever their size. A reasonable minority of candidates incorrectly stated that there was no such thing as the IFRS for SMEs and that all entities have to use full IFRS. A few candidates misinterpreted this part and reflected on the accounting requirements of IFRS 1 *First Time Adoption of IFRS*. As in part (a), the level of knowledge displayed in part (b) was rather disappointing.

[References: IAS 20: para. 12; IAS 41: paras. 4–5, 10, 12–13, 34–38]

Marking scheme

	Marks
(a)	
It is not true that, given the existence of IAS 41 <i>Agriculture</i> other IFRSs do not apply to farming companies. The general presentation requirements of IAS 1 <i>Presentation of Financial Statements</i> , together with the specific recognition and measurement requirements of other IFRSs, apply to farming companies just as much as others.	1
IAS 41 deals with agricultural activity. Two key definitions given in IAS 41 are biological assets and agricultural produce.	$\frac{1}{2} + \frac{1}{2} + \frac{1}{2}$
A biological asset is a living animal or plant. Examples of biological assets would be sheep and fruit trees.	1
The criteria for the recognition of biological assets are basically consistent with other IFRSs, and are based around the <i>Conceptual Framework</i> definition of an asset.	1
A key issue dealt with in IAS 41 is that of measurement of biological assets. Given their nature (eg lambs born to sheep which are existing assets), the use of cost as a measurement basis is impracticable.	$\frac{1}{2} + \frac{1}{2}$
The IAS 41 requirement for biological assets is to measure them at fair value less costs to sell.	$\frac{1}{2} + \frac{1}{2}$
Changes in fair value less costs to sell from one period to another are recognised in profit or loss.	$\frac{1}{2}$
Agricultural produce is the harvested produce of a biological asset. Examples would be wool (from sheep) or fruit (from fruit trees).	1
The issue of measuring 'cost' of such assets is similar to that for biological assets. IAS 41 therefore requires that 'cost' should be fair value less costs to sell at the point of harvesting. This figure is then the deemed 'cost' for the purposes of IAS 2 <i>Inventories</i> .	$\frac{1}{2} + \frac{1}{2} + \frac{1}{2}$
A consequence of the above treatment is that government grants receivable in respect of biological assets are not treated in the way prescribed by IAS 20 <i>Government grants</i> . Where such a grant is unconditional, it should be recognised in profit or loss when it becomes receivable. If conditions attach to the grant, it should be recognised in profit or loss only when the conditions have been met.	$\frac{1}{2} + \frac{1}{2} + \frac{1}{2}$
The IAS 20 treatment of grants is to recognise them in profit or loss as the expenditure to which they relate is recognised. This means that recognition of grants relating to property, plant and equipment takes place over the life of the asset rather than when the relevant conditions are satisfied.	$\frac{1}{12}$
(b)	
The International Accounting Standards Board has developed an IFRS for small and medium sized entities (SMEs) which can be used as an alternative to full IFRS.	$\frac{1}{2} + \frac{1}{2}$
Despite the title of the IFRS for SMEs it is not available for all small and medium sized entities. The standard can only be used by entities which are not publicly accountable. Therefore the standard could not be used by your colleague as the entity is listed.	$\frac{1}{2} + \frac{1}{2} + \frac{1}{2}$
The IFRS for SMEs is one single standard which, if adopted, is used instead of all IFRS.	$\frac{1}{2} + \frac{1}{2}$
The IFRS for SMEs omits completely the requirements of IFRS which are specifically relevant to listed entities, for example, earnings per share and segmental reporting.	$\frac{1}{2} + \frac{1}{2}$

	Marks
In addition, the subject matter included in the IFRS for SMEs has been simplified compared with full IFRS. For example, research and development costs are always expensed.	$\frac{1}{2} + \frac{1}{2} + \frac{1}{2}$
In general terms, the disclosures required by the IFRS for SMEs are considerably less burdensome than for full IFRS.	1
A further benefit is that the IFRS for SMEs is only updated once every three years, thus reducing the extent of change to financial reporting practice.	$\frac{1}{8}$
	<u>20</u>

36 Okawa (12/15)

Top tips. This was a typical discursive question, requiring you to explain two different issues to a non-accountant. Part (a) covered the area of exploration for and evaluation of mineral resources (IFRS 6), which is a peripheral area of the syllabus. However it should be noted that question 4 often covers these peripheral areas. Perhaps to balance this out, part (b) covered the much more mainstream area of assets held for sale (IFRS 5).

Easy marks. Part (b) should have been straightforward.

Examining team's comments. Part (a) of this question was not well answered. A significant number of candidates seemed totally unaware of the provisions of IFRS 6 *Exploration for and Evaluation of Mineral Resources*. Such candidates made general comments about the recognition of tangible and intangible assets and this could only receive limited credit. Whilst IFRS 6 is not a standard that will appear in every exam it is part of the examinable material for this exam and accordingly candidates should devote part of their study time to this subject.

Part (b) was well answered on the whole, with a pleasing level of knowledge being displayed regarding the 'held-for-sale' issues in IFRS 5.

[References: IFRS 5: paras. 6–8, 38; IFRS 6: paras. 3, 8, 10, 12]

Marking scheme

	Marks
(a)	
Expenditure on the exploration for, and evaluation of, mineral resources is excluded from the scope of standards which might be expected to provide guidance in this area. Specifically such expenditure is not covered by IAS 16 <i>Property, Plant and Equipment</i> or IAS 38 <i>Intangible Assets</i> .	$\frac{1}{2} + \frac{1}{2} + \frac{1}{2}$
This has meant that, in the absence of any alternative pronouncements, entities would determine their accounting policies for exploration and evaluation expenditures in accordance with the general requirements of IAS 8 <i>Accounting Policies, Changes in Accounting Estimates and Errors</i> . This could lead to considerable divergence of practice given the diversity of relevant requirements of other standard setting bodies.	$\frac{1}{2} + \frac{1}{2} + \frac{1}{2}$
Given other pressures on its time and resources, the International Accounting Standards Board (IASB) decided in 2002 that it was not able to develop a comprehensive standard in the immediate future.	1
However, recognising the importance of accounting for extractive industries generally the IASB issued IFRS 6 <i>Exploration for and Evaluation of Mineral Resources</i> to achieve some level of standardisation of practice in this area.	1



	Marks
IFRS 6 requires relevant entities to determine a policy specifying which expenditures are recognised as exploration and evaluation assets and apply the policy consistently .	$\frac{1}{2} + \frac{1}{2}$
When recognising exploration and evaluation assets, entities shall consistently classify them as tangible or intangible according to their nature.	1
Subsequent to initial recognition, entities should consistently apply the cost model or the revaluation model to exploration and evaluation assets.	1
If the revaluation model is used, it should be applied according to IAS 16 (for tangible assets) or IAS 38 (for intangible assets).	1
Where circumstances suggest that the carrying amount of an exploration and evaluation asset may exceed its recoverable amount, such assets should be reviewed for impairment. Any impairment loss should basically be measured, presented and disclosed in accordance with IAS 36 <i>Impairment of Assets</i> .	$\frac{1}{10}$
(b)	
The accounting treatment of buildings to be sold is governed by IFRS 5 <i>Non-current Assets Held for Sale and Discontinued Operations</i> .	$\frac{1}{2}$
A building would be classified as held for sale if its carrying amount will be recovered principally through a sale transaction, rather than through continuing use.	$\frac{1}{2}$
For this to be the case, the asset must be available for immediate sale in its present condition. Also management must be committed to a plan to sell the asset and an active programme to locate a buyer must have been initiated. Further, the asset must be actively marketed for sale at a reasonable price. In addition, the sale should be expected to be completed within one year of the date of classification as held for sale (although there are certain circumstances in which the one-year period can be extended). Finally it should be unlikely that significant changes to the plan will be made or that the plan will be withdrawn .	$\frac{1}{2} + \frac{1}{2} + \frac{1}{2} + \frac{1}{2} + \frac{1}{2} + \frac{1}{2} + \frac{1}{2} + \frac{1}{2} + \frac{1}{2} + \frac{1}{2}$
Immediately prior to being classified as held for sale, assets should be stated (or re-stated) at their current carrying amount under relevant International Financial Reporting Standards. Assets then classified as held for sale should be measured at the lower of their current carrying amount and their fair value less costs to sell . Any write down of the assets due to this process would be regarded as an impairment loss and treated in accordance with IAS 36 <i>Impairment of Assets</i> .	$\frac{1}{2} + \frac{1}{2} + \frac{1}{2} + \frac{1}{2} + \frac{1}{2} + \frac{1}{2}$
Assets classified as held for sale should be presented separately from other assets in the statement of financial position.	$\frac{1}{10}$
	<u>20</u>

37 Lambda (12/09)

[References: IFRS 2: paras. 7, 10, 19–21, 30]

(a) Equity-settled

In this case, the fair value of the share-based payment (SBP) to be recognised is the fair value of the equity instruments at the grant date.

This is not all recognised in the financial statements at once, however, but is built up gradually over the vesting period. This is the period between the grant date and the vesting date (the vesting date is when the employee is entitled to receive the equity instruments).

Therefore each year the statement of profit or loss shows the amount of fair value that has been built up during the year – the difference between the fair value of the SBP recognised in the opening and closing statements of financial position.

The statement of financial position shows the fair value of the SBP that has been recognised to date, within equity.

One complication is that the vesting may be subject to certain conditions, so it is not certain what the fair value of the SBP will be. In this case, an estimate should be made based on the information available.

Cash-settled

The liability should be measured at its fair value at the end of the reporting period. The liability should be recognised as the employees render their service.

(b) Scheme A – equity-settled

The vesting period is three years (1 October 20X7 – 30 September 20Y0).

The fair value of the scheme brought forward is $500 \times 185 \times \$2.40 = \$222,000$. The amount that would have been recognised in the statement of financial position for 20X8 was therefore $\$222,000 \times 1/3 = \$74,000$.

The fair value of the scheme carried forward at 30 September 20X9 is $500 \times 188 \times \$2.40 = \$225,600$.

The amount recognised in the statement of financial position for 20X9 was therefore $\$225,600 \times 2/3 = \$150,400$. This is recognised within equity.

The statement of profit or loss charge for 20X9 is therefore $\$150,400 - \$74,000 = \$76,400$.

Scheme B – cash-settled

The employees render their services over the period from 1 October 20X6 to 30 September 20X9 – 3 years.

The fair value of the final liability as at 30 September 20X8 would have been $2 \times 240 \times \$540 = \$259,200$.

The amount that would have been recognised in the statement of financial position for 20X8 was therefore $\$259,200 \times 2/3 = \$172,800$.

The fair value of the final liability as at 30 September 20X9 would have been $2 \times 238 \times \$600 = \$285,600$.

This is recognised in the statement of financial position for 20X9 as a current liability, as it is payable within one year of the period end, on 31 January 20Y0.

The statement of profit or loss charge for 20X9 is therefore $\$285,600 - \$172,800 = \$112,800$.

38 Omega 14 (6/11) (amended)

Top tips. This question divides itself into three parts, and is typical of the current DipIFR examining team.

The first part tested IFRS 2 *Share-based Payment*, and is actually quite straightforward. It does, however, contain a difficulty which could have put you off if you did not know the area well. This related to market-related vesting conditions: IFRS 2 states that the transaction is recognised irrespective of whether or not they are satisfied. If you knew this, then the rest of the question should have been simple. If you didn't, then you needed to stay positive about what you do know. There are two possibilities: (i) this share price does matter, in which case the fair value would be \$nil because no options would vest; (ii) the share price doesn't matter, in which case you calculate the fair value as usual. In this case, the time you have for this part of the question is probably best spent assuming that the share price doesn't matter, as there are likely to be marks available for your calculation based on the information given in the rest of the scenario.

The second part of the question tested IAS 16 and IAS 8. You should be very comfortable with both of these standards. The question was perhaps unclear on whether the \$3m overhaul costs had already been capitalised, and you may have assumed that they had not been. Don't worry if you got this wrong, as you will be awarded marks for everything you get right, so that you should still be able to pass the question.

The third part of the question tests IFRS 15 *Revenue from Contracts with Customers*.

Easy marks. There were 1½ easy marks in part (a) for just stating the accounting treatment in the SPLOCI. The marks for laying out the financial statements extracts were also easy – you just need to know where the figures should go.

[References: IFRS 15: paras. 73–75; IAS 8: paras. 41–49; IAS 16: para. 14]

Marking scheme

Marks

(a)

OMEGA – STATEMENT OF FINANCIAL POSITION

Year ending

31 March 20X8

31 March 20X7

\$'000

\$'000

Recognised in retained earnings

912

304

OMEGA – STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME

Year ending

31 March 20X8

31 March 20X7

\$'000

\$'000

Operating expenses

608

304

Cumulative profits estimated at 31 March 20X7 are \$8m, so 10,000 options vest per director. There are 20 directors, but one left before March 20X7 to leave 19. The fair value of an option at the grant date is \$4.80. Hence the total liability/expense for the three years is $10,000 \times 19 \times \$4.80 = \$912,000$. At the year ended 31 March 20X7, $\$912,000 \div 3 = \$304,000$ is recognised in the financial statements.

The vesting condition relating to the share price at 31 March 20X9 is ignored as a market condition per IFRS 2 *Share-based Payment*.

The statement of financial position recognises the estimated total liability directly within retained earnings. The statement of profit or loss and other comprehensive income recognises the increase in the liability over the amount previously recognised, which in 20X7 is \$304,000.

Cumulative profits estimate at 31 March 20X8 are \$14m, so 15,000 options vest per director. Hence the total liability/expense is $15,000 \times 19 \times \$4.80 = \$1,368,000$. The amount recognised in retained earnings is $\$1,368,000 \times 2/3 = \$912,000$. The expense is $\$912,000 - \$304,000 = \$608,000$.

(b)

OMEGA – STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME

Year ending

31 March 20X8

31 March 20X7

\$'000

\$'000

Depreciation

15,000

15,000

OMEGA – STATEMENT OF CHANGES IN EQUITY

Year ending 31 March 20X8

\$'000

(3,000)

Adjustment to opening retained earnings



Assets and depreciation

IAS 16 *Property, Plant and Equipment* requires that overhaul costs be capitalised and depreciated over their useful life, ie the period until the next overhaul.

1

Assuming that the \$12m capitalised per machine already includes a provision of \$3m for overhaul costs, this \$12m needs to split into the costs relating to the overhaul provision (\$3m) and the machine cost (\$9m).

The total overhaul costs capitalised are $\$3m \times 10 = \$30m$. This is depreciated over 5 years, resulting in an annual depreciation expense of $\$30m \div 5 = \$6m$.

½

The total machine costs capitalised are $\$9m \times 10 = \$90m$. This is depreciated over 10 years, resulting in an annual depreciation expense of \$9m.

½

Total depreciation charged is thus \$15m.

Prior period error

Depreciation of \$15m should have been charged in 20X7, but only \$12m was charged. Hence operating profit was overstated by \$3m.

IAS 8 requires that this be accounted for retrospectively as a prior period error. Opening retained earnings will be reduced by \$3m, and the comparative amounts included within the 20X8 financial statements will be restated to reflect a depreciation expense of \$15m.

1
5

(c) STATEMENT OF FINANCIAL POSITION AS AT 31 MARCH 20X8

	\$'000	
Non-current liabilities – deferred revenue	662	1½
Current liabilities – deferred revenue	441	1½

STATEMENT OF PROFIT OR LOSS FOR THE YEAR ENDED 31 MARCH 20X8

	\$'000	
Revenue from sale of machine	6,176	1
Service revenue	221	1
Total revenue	6,397	
Cost of sales of the machine	(4,000)	1
Cost of service element	(200)	1
	<u>2,197</u>	<u>7</u>
		<u>20</u>

Explanation

IFRS 15 states that where a contract contains more than one distinct performance obligation, a company allocates the transaction price to all separate performance obligations in proportion to the stand-alone selling price of the good or service underlying each performance obligation. Total revenue of \$7.5m is divided into sales and service elements. Total costs of servicing are \$1.2m ($= \$200,000 \times 2 \times 3$). Adding a normal gross margin of 20% to this gives revenue allocated of \$1.5m ($= \$1.2m \div 0.8$).

Revenue from the sale of the machine of \$6.176 m ($7/8.5 \times 7.5m$) is recognised on 1 October 20X7, when the machine is delivered to the customer.

Service revenue is recognised on a straight line basis over the three year period, resulting in deferred revenue in the first two years. \$221,000 ($1.5/8.5 \times \$7.5m \times 6/36$) is recognised in the year ended 2011, with deferred revenue of \$1.103m ($1.5/8.5 \times 7.5 \times 30/36$). This is split into current liabilities of \$0.441m ($\$1.103m \times 12/30$) and non-current liabilities of \$0.662m ($\$1.103m \times 18/30$).



39 Delta (6/14) (amended)

Top tips. This question covered three distinct topics. With all three parts, start by explaining the required treatment and then apply it to the scenario in the question, with calculations where possible.

Part (a) on share-based payment may have looked difficult, but many of the marks were for calculations with which by now you should be thoroughly familiar.

Part (b) focused on revenue recognition, which is now covered by IFRS 15 *Revenue from Contracts with Customers*. At first sight, this may have seemed like an unfamiliar situation, but you should have seen fairly quickly that this is a sale and repurchase agreement – a financing transaction, giving rise to a financial liability, rather than to sales revenue.

In part (c), you needed to identify that the non-refundable deposit would not form part of the lease liability, other than that this was a straightforward calculation of the lease liability and right-of-use asset under IFRS 16.

Easy marks. There were plenty of easy marks available for stating the basic principles of IFRS 2 and IFRS 16.

Examining team's comments. On the whole the answers to this three-part analysis question were satisfactory. Roughly half the candidates answering part (a) did so from the incorrect perspective that the transaction with the executives was equity settled, rather than cash settled. Part (b) was answered well and most correctly concluded that the sale of the inventory should not stand given the conditions attaching to it.

[References: IFRS 2: paras. 7, 30–33; IFRS 15: paras. 34, B64–B76; IFRS 16: paras. 22–43]

Marking scheme

	Marks
(a) Under the principles of IFRS 2 <i>Share-based Payment</i> the granting of share appreciation rights (SARs) to executives is a cash-settled share-based payment.	1
Cash-settled share-based payments create a liability in the statement of the financial position as they will ultimately be redeemed in cash.	1
The liability is recognised based on the fair value of the SAR at the reporting date and the expected number of rights which will vest.	$\frac{1}{2} + \frac{1}{2} + \frac{1}{2}$
Under the principles of IFRS 2 this liability is built up over the vesting period.	1
Therefore the liability at 31 March 20X4 would be \$412,960 ($2,000 \times (200 - 10 - 5 - 7) \times \$1.74 \times \frac{2}{3}$).	1
Since the rights are not exercisable until after 31 March 20X5, the liability would be shown as a non-current liability.	$\frac{1}{2}$
The liability at 31 March 20X3 would have been \$216,000 ($2,000 \times (200 - 10 - 10) \times \$1.80 \times \frac{1}{3}$).	1
The charge to profit or loss would be \$196,960 – the difference between the closing liability (\$412,960) and the opening liability (\$216,000). This charge would be shown as an operating cost.	$\frac{1}{8}$
	<u>8</u>

- (b) This transaction is governed by the principles of IFRS 15 *Revenue from Contracts with Customers*. ½
- Given Delta's continued responsibility for the custody of the goods, and the fact that they are highly likely to be repurchased, it is clear that Delta has entered in to a repurchase agreement involving a call option over the goods. 1½
- IFRS 15 states that where the entity has the right to repurchase the goods, and the repurchase price is greater than the original selling price the contract should be treated as a financing arrangement. ½
- Therefore, the goods will remain in inventory at cost – being their manufactured cost of \$800,000 plus one year's storage costs (or their net realisable value, if this is lower than cost). 1
- The net proceeds of \$800,000, being a financial liability, are accounted for under the principles of IFRS 9 *Financial Instruments*. ½
- Under IFRS 9, most financial liabilities are measured at amortised cost using the effective interest method and this would certainly apply here. 1
- The finance cost for the period would be \$64,000 ($\$800,000 \times 8\%$). This would be shown in the statement of profit or loss. 1
- The closing financial liability would be \$864,000 ($\$800,000 + \$64,000$). This would be shown as a current liability since the 'repurchase' occurs on 31 March 20X5 – 12 months after the reporting date. 1
- 7
- (c) The statement of financial position should show a lease liability and a right-of-use asset relating to the lease. At commencement of the lease, the lease liability is measured at the present value of the future lease payments, being $\$2,000 \times \$4.712 = \$9,424$. 1
- At 31 March 20X4, the lease liability is increased for the interest implicit in the lease, being 11%, and reduced by the rental payment of \$2,000 to give an outstanding liability at 31 March 20X4 of \$8,461 (W1). 1
- \$7,392 of this amount will be shown as a non-current liability and the remaining \$1,069 ($\$8,461 - \$7,392$) will be shown as a current liability. The interest charge of \$1,037 will be shown as a finance cost in the statement of profit or loss for the year ended 31 March 20X4. 1

Working: Lease liability profile

Year ended 31 March	Bal b/f	Interest (11% of bal b/f)	Rental	Bal c/f
	\$	\$	\$	\$
20X4	9,424	1,037	(2,000)	8,461
20X5	8,461	931	(2,000)	7,392



Marks

Right-of-use asset

At the commencement date of the lease, so at 1 April 20X3, the right-of-use asset is measured as:

	\$'000
Lease liability	9,424
Non-refundable deposit	575
Right-of-use asset	<u>9,999</u>

The right-of-use asset is then depreciated over seven years, being the shorter of the lease term and the useful life of the asset: $9,999/7 = \$1,428$. This charge is shown in the statement of profit or loss for the year ended 31 March 20X4. The balance of the right-of-use asset is shown as a non-current asset in the statement of financial position: $\$9,999 - \$1,428 = \$8,571$.

1

1

520

40 Kappa (6/15)

Top tips. This question asked you to explain and apply the provisions of IFRS 2 on share-based payments. This topic is examined very frequently and you are advised to have a good knowledge of it.

Easy marks. Part (a) had lots of easy marks, and most of the calculation in part (b) were quite straightforward also.

Examining team's comments. Part (a) was answered well by most candidates. A minority of candidates lost marks by not addressing the questions specifically enough and writing about share based payments too generally. Some candidates repeated information about IFRS 2 that was given in the question. This clearly attracted no marks.

Candidates found part b(i) challenging on the whole. A reasonable number were able to compute the cost based on the initial share award, by basing the cost on the fair value of the option at the grant date and the expected numbers vesting based on the best estimate at the reporting date. However very few candidates were able to deal with the modification to the award that was necessary because of the fall in Kappa's share price in the year ended 31 March 2014. It would appear that in general candidates had not studied this aspect of accounting for share based payments.

Answers to part b(ii) were on the whole satisfactory. Having said this, only a minority of candidates correctly identified the liability as non-current.

[References: IFRS 2: 7, 10–21, 30–33D]

Marking scheme

Marks

(a)

- | | | |
|-----|---|-------|
| (i) | For equity-settled share-based payment arrangements, the transaction should be measured based on the fair value of the goods or services received, or to be received. | ½ |
| | Where the third party is an employee, 'fair value' should be based on the fair value of the equity instruments granted, measured at the grant date. | ½ + ½ |
| | For cash-settled share-based payment arrangements, the transaction should be measured based on the fair value of the liability at each reporting date. | ½ + ½ |



		Marks
(ii)	The amount recognised should take account of all vesting conditions other than (in the case of equity-settled share-based payment arrangements) market conditions (which are reflected in the measurement of the fair value of the instruments granted).	$\frac{1}{2} + \frac{1}{2} + \frac{1}{2}$
(iii)	For both types of arrangement, the debit entry will normally be to profit or loss unless the relevant expense would qualify for recognition as an asset.	1
	For an equity-settled share-based payment arrangement, the credit entry would be recognised in equity, either as share capital or (more commonly) as an option reserve.	$\frac{1}{2}$
	For cash-settled share-based payment arrangements, the credit entry would be recognised as a liability.	$\frac{1}{2}$
		<u>6</u>
(b)		
(i)	The expected total cost of the arrangement at 31 March 20X4 is $400 \times \$1.50 \times (500 - 10 - 20) = \$282,000$.	1
	Therefore \$70,500 ($\$282,000 \times \frac{1}{4}$) would be credited to equity and debited to profit or loss for the year ended 31 March 20X4.	1
	For the year ended 31 March 20X5, the expected total cost of the originally granted options would be $400 \times \$1.50 \times (500 - 10 - 5 - 10) = \$285,000$.	1
	The cumulative amount taken to profit or loss and recognised in equity at 31 March 20X5 is \$142,500.	1
	The additional cost of the repriced options must also be recognised over the three-year period to 31 March 20X7.	$\frac{1}{2} + \frac{1}{2}$
	The total additional cost is $400 \times (\$1.45 - \$0.25) \times 475 = \$228,000$.	1
	Therefore the amount recognised in the year ended 31 March 20X5 is \$76,000 ($\$228,000 \times \frac{1}{3}$). Therefore the total recognised in equity at 31 March 20X5 is \$218,500 ($\$142,500 + \$76,000$).	1
	The amount recognised in equity would be shown as 'other components of equity'.	$\frac{1}{2}$
	And the charge to profit or loss for the year ended 31 March 20X5 is \$148,000 ($\$142,500 + \$76,000 - \$70,500$).	1
	The amount recognised in profit or loss would be shown as an employment expense.	$\frac{1}{2}$
		<u>9</u>
(ii)	For the year ended 31 March 20X4, the expected total cost will be $50 \times 1,000 \times \$0.90 = \$45,000$.	1
	The amount taken to profit or loss in the prior period, and recognised as a liability, will be \$15,000 ($\$45,000 \times \frac{1}{3}$).	1
	At 31 March 20X5, the liability will be $50 \times 2,000 \times \$1.20 \times \frac{2}{3} = \$80,000$.	1
	Since the rights are exercisable on 30 June 20X6, the liability will be non-current.	1
	The charge to profit or loss for the year ended 31 March 20X5 will be \$65,000 ($\$80,000 - \$15,000$). This will be included in employment expenses.	$\frac{1}{2}$
		<u>5</u>
		<u>20</u>

41 Roma (6/16)

Top tips. This question asked you to explain and show how the three events would be reported in the financial statements of Roma. In part (a) you had to correctly identify that the share options were equity settled, and then explain how to account for them under IFRS 2. The repricing of the option was tricky, but you could still have gained many of the marks for part (a) without getting that bit correct. Part (b) was straightforward if you had practiced applying IAS 37. You needed to identify that a provision was required and that a contingent asset should be disclosed. Part (c) required you to spot that related parties were involved. The fact that the spouse of a director was mentioned in the question should have highlighted to you that related parties were potentially an issue – if they didn't, make sure you spot that next time!

Easy marks. Part (b) had lots of easy marks available for applying your knowledge of provisions and contingent assets.

Examining team's comments. Part (a) was generally satisfactorily answered. Candidates found it difficult to deal with the re-pricing. Some candidates used the term 'option reserve' without stating that this is equity and failed to score any marks because 'reserve' may well refer to a liability. Not all candidates wrote that employment expense should be charged to profit or loss under operating costs. Mentioning 'other comprehensive income' is not correct because there are profit or loss and other comprehensive income at the same time. Mentioning provision or reserve cost is not correct either.

Part (b) was a popular part of the question and many candidates correctly classified a claim to S as a contingent asset. But not all of them noted that it was included in the disclosure to the financial statements. Many candidates correctly identified the adjusting event but some incorrectly stated the amount recognised as the best estimate of the amount required to settle the obligation. This should be the estimate made just before the financial statements are authorised for issue. Most candidates mentioned 'provision' without any clarification that this is a liability as opposed to part of equity.

In part (c) it was necessary for candidates not only to mention related parties but also name them and explain why they should be treated as related parties.

[References: IFRS 2: paras. 7, 10–21, 26–29; IAS 24: paras. 9, 13–24; IAS 37: paras. 10, 14, 31–34]

Marking scheme

	Marks
(a) IFRS 2 <i>Share-based Payments</i> requires that equity-settled share-based payments should be measured based on their fair value at the grant date , based on the number of options expected to vest based on estimates at the reporting date .	$\frac{1}{2} + \frac{1}{2} + \frac{1}{2} + \frac{1}{2}$
The cost should be spread over the vesting period – three years in this case.	$\frac{1}{2}$
This means that the charge to profit or loss in the year ended 31 March 20X5 will be \$740,000 ($1,850 \times 1,000 \times \$1.20 \times 1/3$).	$\frac{1}{2}$
The credit entry will be to equity , probably to an option reserve .	$\frac{1}{2} + \frac{1}{2}$
Based on the original arrangements, the cumulative balance in equity on 31 March 20X6 will be \$1,472,000 ($1,840 \times 1,000 \times \$1.20 \times 2/3$).	$\frac{1}{2} + \frac{1}{2} + \frac{1}{2}$
The impact of the repricing on 30 September 20X5 is to charge the incremental increase in fair value over the remaining vesting period on the same basis as the original charge.	$\frac{1}{2} + \frac{1}{2} + \frac{1}{2}$
Therefore the additional credit to equity in respect of the repricing will be \$92,000 ($1,840 \times 1,000 \times \{\$1.05 - \$0.90\} \times 6/18$).	$\frac{1}{2}$



	Marks
This means the closing balance in equity will be \$1,564,000 (\$1,472,000 + \$92,000).	½
The charge to profit or loss in the year ended 31 March 20X6 will be \$824,000 (\$1,564,000 – \$740,000). This will be shown as an employment expense under operating costs .	<u>1</u> 9
(b) The potential liability to pay damages to C needs to be recognised as a provision because the event giving rise to the potential liability (the supply of faulty products) arose prior to 31 March 20X6, there is a probable transfer of economic benefits and a reliable estimate can be made of the amount of the probable transfer.	½ + ½ + ½
The amount recognised should be the best estimate of the amount required to settle the obligation at the reporting date. In this case, this estimate is the one made on 15 May – just before the financial statements are authorised for issue. Therefore a provision of \$5.25 million should be recognised as a current liability . There should also be a charge of \$5.25 million to profit or loss .	½ + ½ + ½
The potential amount receivable from S is a contingent asset as it arose from an event prior to the year end but at the date the financial statements are authorised for issue , the ultimate outcome is uncertain.	½ + ½ + ½
Contingent assets are not recognised as assets in the statement of financial position. Their existence and estimated financial effect is disclosed where the future receipt of economic benefits is probable . This is the situation here.	<u>½ + ½ + ½</u> 6
(c) Roma would include the total revenue of \$6.8m (\$6m + \$800,000) from entity X receivable in the year ended 31 March 20X6 within its revenue and show \$1.8m within trade receivables at 31 March 20X6.	1
The spouse of a director of Roma would be regarded as a related party of Roma because he/she is a close family member of one of the key management personnel of Roma.	½ + ½ + ½
From 1 June 20X5 , entity X would also be regarded as a related party of Roma because from that date entity X is an entity controlled by another related party .	½ + ½
Because entity X is a related party with whom Roma has transactions, then Roma should disclose:	
• The nature of the related party relationship.	
• The revenue of \$6m from entity X since 1 June 20X5.	
• The outstanding balance of \$1.8m at 31 March 20X6. In the current circumstances it may well be necessary for Roma to also disclose the favourable terms under which the transactions are carried out.	1½
	<u>5</u> 20

42 Epsilon 11 (6/12)

Top tips. This question covered IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*. **Part (b)** is a practical illustration of the principles laid out in **part (a)**.

Easy marks. **Part (a)** is largely book knowledge that you should have found straightforward to answer, if you have studied.

Examining team's comments. Most of **part (a)** was generally well answered, though explanations of the meaning of discontinued operations were disappointing.

In **part (b)** computations of the overall impairment loss were generally good and a pleasing number of candidates were aware that impairment losses on goodwill can never be reversed. However, explanations of how the balance of the impairment loss of \$12m would be treated, and the issues of a discontinued operation were largely not addressed.

[References: IFRS 5: paras. 6–8, 15–19, 31–33, 38]

Marking scheme

		Marks
(a)	(i)	
	An entity classifies an asset or disposal group as held for sale if its carrying amount will be principally recovered through a sale transaction rather than through continuing use.	1
	For this to be the case, the asset must be available for immediate sale in its present condition and the sale must be highly probable. For the sale to be highly probable, management must be committed to selling the asset or disposal group and be actively marketing the asset or disposal group at a reasonable price. In addition, the sale should be expected to qualify for recognition within one year of the date of classification.	1
	(ii)	
	An asset or disposal group that is classified as held for sale should be measured at the lower of the carrying amount and fair value (arms' length sale price) less costs to sell.	1
	When an asset or disposal group is classified as held for sale no further depreciation charges should be made on the asset or the disposal group.	½
	An entity should present an asset classified as held for sale and the assets of a disposal group classified as held for sale separately from other assets in the statement of financial position.	1
	The liabilities of a disposal group classified as held for sale should be presented separately from other liabilities in the statement of financial position. They should not be offset against the assets of the disposal group.	½
	Costs to sell are the incremental costs of selling the asset or disposal group, excluding finance costs and income tax expense.	1
	(iii)	
	A discontinued operation is a component of an entity that either has been disposed of in the period or classified as held for sale and:	1
	Represents a separate major line of business or area of operations;	½
	Is part of a single co-ordinated plan to dispose of a separate major line of business or area of operations; or	½
	Is a subsidiary acquired exclusively with a view to resale.	½
	(iv)	
	The minimum disclosure requirements for discontinued operations on the face of the statement of profit or loss and other comprehensive income is a single amount representing the total of:	
	The post-tax profit or loss of discontinued operations.	
	The post-tax gain or loss recognised on the measurement to fair value less costs to sell or on the disposal of the assets or disposal groups constituting the discontinued operation.	1½
		<u>10</u>



	Marks
(b) On 1 October 20X1, it is necessary to compare the carrying amount of the business component (\$40m) with its fair value less costs to sell (\$28m). Since fair value less costs to sell is lower, the business component is written down to \$28m, resulting in a loss of \$12m.	1
This loss of \$12m is regarded as an impairment loss that is treated in accordance with IAS 36 <i>Impairment of Assets</i> .	½
The impairment loss is first allocated to the goodwill, leaving a nil balance.	1
The balance of the impairment loss of \$2m (\$12m – \$10m) is allocated to property, plant and equipment, leaving a balance of \$23m (\$25m – \$2m).	1½
Because the property, plant and equipment is part of a disposal group that is classified as held for sale, it is not subjected to further depreciation after 1 October 20X1.	1
By 31 March 20X2 the estimated disposal proceeds of the business had increased to \$31m. This means that part of the impairment loss has reversed.	½
The reversal of an impairment loss on goodwill is not permitted. Its carrying amount remains at nil.	1
However, a reversal of \$2m can be recognised on the property, plant and equipment at 31 March 20X2, restoring its carrying amount to \$25m.	1
The business component is a discontinued operation because it is a component of Delta that has been classified as held for sale by 31 March 20X2.	1
Therefore Delta will disclose a single amount on the face of the statement of profit or loss and other comprehensive income.	½
This amount will comprise the profit after tax of \$3m and the net amount recognised as an impairment loss of \$10m (\$12m – \$2m).	1
	<u>10</u>
	<u>20</u>

43 Belloso Co

- (a) (i) The substance of the situation is that a sale has not been made. Belloso Co did not supply the goods requested and has agreed to refund the cash. The sale would therefore be reversed and the inventory written back in the accounts for 20X1.

<i>Journal to reverse sale</i>		\$	\$
DEBIT	Sales (Returns)	2,400	
CREDIT	Refunds payable		2,400

If Intuoso Co has a debit balance on its receivable account the refund payable should be netted off against it. However, if there is not a receivable account for Intuoso Co the refund payable will be shown as a liability on the statement of financial position.

<i>Journal to write back inventory</i>		\$	\$
DEBIT	Inventory SOFP	2,000	
CREDIT	Inventory SP/L (cost of sales)		2,000

- (ii) This is a provision according to IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, since there is a liability of uncertain timing and amount. The criteria for recognising a provision are:

- Present obligation exists as a result of a past event
- There will be a probable outflow of resources
- A reasonable estimate can be made of the amount of the obligation

We have to take the lawyer's expert opinion that there is an obligation. The past event was the supply of faulty goods. Belloso Co will probably have to pay (outflow of resources) and the amount has been estimated at \$10,000.

The journal adjustment necessary is:

		\$	\$
DEBIT	Expenses SP/L	10,000	
CREDIT	Provisions SOFP		10,000

The provision will be shown separately on the face of the statement of financial position, under current liabilities if the money is expected to be paid within the next 12 months.

Additional disclosure is necessary. The following disclosures should be made:

- Description of the nature of the obligation and expected timing of payment
- An indication of the uncertainties about the amount or timing

Due to its materiality this expense should be separately disclosed on the face of the statement of profit or loss.

- (iii) At 31 December 20X1 there is a contingent asset of \$4,000, according to IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. A contingent asset is a possible asset that arises from past events and whose existence will be confirmed by the occurrence or non-occurrence of uncertain future events.

The past event was the supply of goods to Changeoso. The uncertain event in the decision / ability of the liquidators to pay Beloso Co the \$4,000. Being a contingent asset in 20X1 there will be no adjustment in the statement of profit or loss or statement of financial position but disclosure in the notes to the accounts is necessary. The nature of the contingent asset and the estimated amount of \$4,000 should be disclosed.

- (iv) There has been a material error that must be dealt with in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. The treatment according to IAS 8 is to adjust the opening balance of retained earnings and comparative information should be restated.

<i>Journal 20X1</i>		\$	\$
DEBIT	Cost of sales	17,000	
CREDIT	Opening reserves		17,000

(b) STATEMENT OF CHANGES IN EQUITY FOR BELLOSO CO 20X1

Retained earnings

	\$	
Balance at 1 January 20X0	52,000	
Profit for the year ended 31 December 20X0	45,000	(28,000 + 17,000)
Balance at 31 December 20X0	<u>97,000</u>	
Balance at 31 December, 20X0 as previously reported	80,000	(52,000 + 28,000)
Prior period adjustment	17,000	
Adjusted balance at 31 December 20X0	<u>97,000</u>	
Profit for year ended 31 December 20X0	<u>(7,400)</u>	(W1)
	<u>89,600</u>	

Workings

	\$
Profit for the year per question	20,000
(i) Sales returns	(400)
(ii) Provision	(10,000)
(iii) Error	(17,000)
	<u>(7,400)</u>



44 Epsilon 3 (12/05)

- (a) Two key financial reporting standards inform the correct treatment of this issue. IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* states that non-current assets that are held for sale should be separately classified on the statement of financial position and measured at the lower of existing carrying amount and fair value less costs to sell. IFRS 5 further states that the results of discontinued operations should be separately disclosed in the statement of profit or loss. IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* requires that provisions should be made for the unavoidable consequences of events occurring before the end of the reporting period.

As far as the issue of a provision is concerned the steps taken before the end of the reporting period have effectively committed the entity to the closure. The basic principle laid down in IAS 37 is that provision should be made for the direct costs associated with the closure. On this basis the expected redundancy costs and the contract termination costs (items (a) and (d) – total \$20m + \$5m = \$25m) should be provided for. A further cost associated with the closure is the cost of terminating the pension rights of the employees who accept redundancy (item (b) \$10m). IAS 19 *Employee Benefits* requires that the costs of settlement or curtailment of pension rights are a one-off amount that should be recognised in profit or loss of a contributing entity. Given that a provision is appropriate, then this cost should be recognised.

The cost of redeployment and retraining (item (c)) is an ongoing cost associated with the continuing business and IAS 37 specifically states that restructuring provisions should not include those items. The treatment of expected operating losses (item (g)) is also dealt with in IAS 37. IAS 37 states that a provision is inappropriate unless the losses are anticipated to arise on an onerous contract.

Therefore the total provision for closure should be \$35m (\$25m + \$10m).

As far as the non-current assets of the segment are concerned these satisfy the IFRS 5 criteria for assets held for sale. An asset is classified as held for sale if its value will be recovered principally through sale as opposed to continuing use. The implications of this classification is that the plant and property will be classified as held for sale on the statement of financial position and measured at the lower of existing carrying amount and fair value less costs to sell. This means that the plant and equipment will be written down by \$11m to \$1m but that the property will continue to be carried at \$10m.

Under the principles of IFRS 5 it would be correct to show the results separately if the segment can be regarded as a discontinued operation. In order for this to be the case the segment would have to be:

A component of the entity (where operations and cash flows can be clearly distinguished, operationally and for financial reporting purposes, from the rest of the entity) that either has been disposed of or is classified as held for sale and:

- Represents a separate major line of business or geographical area of operations;
- Is part of a single coordinated plan to dispose of a separate major line of business or geographical area of operations; or
- Is a subsidiary acquired exclusively with a view to resale.

In this case it appears that the segment would be regarded as a discontinued operation. This means that Epsilon needs to disclose a single amount on statement of profit or loss comprising the total of:

- The post-tax profit or loss of the discontinued operation; and
- The post-tax gain or loss recognised on the measurement to fair value less costs to sell of the assets of the discontinued operation.

- (b) The unrealised profit of \$1m would need to be eliminated from the consolidated inventory figure and charged against the ownership interests in the consolidated statement of financial position. Since the profit is made by a subsidiary the charge to ownership interests would be allocated between the parent and the non-controlling interest unless the subsidiary is wholly owned.

The adjustment for unrealised profit creates a temporary difference because the current tax position of the group is unaffected by the provision or by its reversal when the inventory is sold outside the group. The temporary difference would be regarded as a deferred tax asset.

The same applies to the tax loss because no tax relief has yet been given but relief will be available in the future against taxable profits. The total temporary difference is \$5m (\$1m + \$4m) and the potential deferred tax is \$1.5m ($30\% \times \5m).

Since the deferred tax amount is a deferred tax asset then the question of recoverability arises. IAS 12 *Income Taxes* states that deferred tax assets can be carried forward where recovery is assured beyond reasonable doubt. In this case recoverability depends on the availability of taxable profits in the future to absorb the temporary differences. It would appear from the information given that these will be available for the subsidiary. The deferred tax asset will be shown in current assets and should not be offset against deferred tax credit balances unless they relate to the same tax jurisdiction.

45 Omega 11 (2011 Pilot Exam)

BPP Study Text references. Chapters 4, 8 and 14.

Top tips. IFRS 5 and IAS 37 are both core standards that you should be very familiar with. However, this fact was partially compensated for by the level of detail required in relation to Issue 1. You should have been able to score well here, but if you struggled then you need to make sure that you are familiar with your core standards for DipIFR – roughly Chapters 3 to 8 in the BPP Study Text. Although they are not difficult to understand, they can be difficult in an exam context if you haven't paid sufficient attention to the detail.

Issue 2 was actually not difficult. Share-based payments is an area that sometimes intimidates students, but often needlessly so. If you were comfortable with the basic requirements of IFRS 2 then you should have scored well here.

Easy marks. There were easy marks for recognising the basic required treatment of each part of issue one. Issue two was on share-based payment, an area which is very likely to be examined and which you should be comfortable with.

Marking scheme

Issue 1

Marks

Two key Standards inform the treatment of this issue:

IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* requires provisions to be made for the unavoidable consequences of events occurring before the end of the reporting period.

IFRS 5 *Non-current Assets and Held for Sale and Discontinued Operations* states that non-current assets that are held for sale should be separately classified on the statement of financial position, and measured at the lower of carrying amount and fair value less costs to sell. The results of any discontinued operations should be separately disclosed on the statement of profit or loss and other comprehensive income.

As far as the issue of a provision is concerned the steps taken before the end of the reporting period have effectively committed the entity to the closure. The basic principle laid down in IAS 37 is that provision should be made for the direct costs associated with the closure. Taking each issue in turn: 1

(a), (d) On this basis the expected redundancy costs and the contract termination costs (total \$20m + \$5m = \$25m) should be provided for. 1

(b) A further cost associated with the closure is the net cost of terminating the pension rights of the employees who accept redundancy (\$10m – \$7.5m = \$2.5m). IAS 19 *Employee Benefits* requires that the costs of settlement or curtailment of pension rights are a one-off amount that should be recognised in the statement of profit or loss and other comprehensive income of a contributing entity. Given that a provision is appropriate, then this cost should be recognised. 2

		Marks
(c)	The cost of redeployment and retraining is an ongoing cost associated with the continuing business and IAS 37 specifically states that restructuring provisions should not include those items.	1
(g)	The treatment of expected operating losses is also dealt with in IAS 37. IAS 37 states that a provision is inappropriate unless the losses are anticipated to arise on an onerous contract. Therefore the total provision for closure should be \$25m. The net pension asset/liability will be reduced/increased by the \$2.5m.	1
(e), (f)	The non-current assets satisfy the IFRS 5 criteria for assets held for sale. An asset is classified as held for sale if its value will be recovered principally through sale as opposed to continuing use. The implications of this classification is that the plant and property will be classified as held for sale on the statement of financial position and measured at the lower of existing carrying amount and fair value less costs to sell . This means that Epsilon will write down the plant and equipment from \$11m to \$2m , but that the property will continue to be carried at only \$10m. The net assets of the segment will be regarded as a disposal group and will be classified separately on the statement of financial position.	1 + 1 + 1 + 1
(g)	Under the principles of IFRS 5 it would be correct to show the results separately if the segment can be regarded as a discontinued operation. In order for this to be the case the segment would have to be: A component of the entity (where operations and cash flows can be clearly distinguished, operationally and for financial reporting purposes, from the rest of the entity) that either has been disposed of or is classified as held for sale and:	½
	<ul style="list-style-type: none"> Represents a separate major line of business or geographical area of operations; 	½
	<ul style="list-style-type: none"> Is part of a single co-ordinated plan to dispose of a separate major line of business or geographical area of operations; or 	½
	<ul style="list-style-type: none"> Is a subsidiary acquired exclusively with a view to resale. 	½
	The segment would thus be regarded as a discontinued operation. Epsilon needs to disclose a single amount on the face of the statement of profit or loss and other comprehensive income, comprising the total of:	1
	<ul style="list-style-type: none"> The post-tax profit or loss of the discontinued operation; and 	½
	<ul style="list-style-type: none"> The post-tax gain or loss recognised on the measurement to fair value less costs to sell of the assets of the discontinued operation. 	½
		<u>14</u>
	Further disclosures relating to discontinued operations are then required:	
	<ul style="list-style-type: none"> The revenue, expenses and pre-tax profit or loss The related income tax expense The gain or loss recognised on the measurement to fair value less costs to sell or on the disposal of the assets of the discontinued operation (both before and after tax) 	

Marks

Issue 2

This is an **equity settled share-based payment** that is dealt with under IFRS 2 *Share-based Payment*. This is measured at the fair value of the equity instruments that are likely to be issued (ie share options), rather than the fair value of the related goods or services provided. In the case of share options that **fair value is measured at grant date** and not amended subsequently so the transaction is measured at \$1.80 per option.

1 + 1

Where there are **non-market-based vesting conditions**, the total cost of the transaction is measured with reference to the likelihood of these conditions being satisfied so the **total cost** of the share-based payment in this case will be $200,000 \times \$1.80 = \$360,000$. This is recognised in the statement of profit or loss and other comprehensive income over the vesting period so a charge of $\frac{6}{9} \times \$360,000 = \$240,000$ will be made in the year ended 31 March 20X1. The **credit** is to a share options account that is presented in equity.

1 + 1 + 1

IFRS 2 requires disclosure of information that enables users of the financial statements to understand the nature and extent of share-based payment arrangements that existed during the period. Therefore the key terms and vesting conditions would need to be disclosed in the financial statements.

$$\begin{array}{r} 1 \\ 6 \\ \hline 20 \end{array}$$

46 Delta (12/13) (amended)

Top tips. This question covered three areas which are fairly central to the syllabus, so if you struggled with any of it then this will give you an indication of where you need to focus your work before the exam. Part (a) on financial instruments was actually not that difficult, even though it was on financial instruments which is a topic which sometimes elicits panic from candidates! It serves as a good illustration of a question where keeping calm pays off, as there were plenty of marks available for simply stating the required treatment of the financial asset on initial recognition.

Part (b) was on a familiar syllabus area. As with part (a), your approach should be to state the required treatment and then apply it to the question. Be careful, however, not to enter into any long discussions of general accounting principles – keep your answer focused on the question.

Part (c) required the application of the exemptions in IFRS 16.

Easy marks. There are easy marks in part (a) for computing the cost of the asset, and for stating that it will be split into its current and non-current elements.

Examining team's comments. On the whole many candidates failed to score well on this question. Many left out part (a), which was the least well answered.

Part (a) – the financial asset

- Very few discussed the fact that this was valued at amortised cost and even fewer explained why. Some suggested this was a liability not an asset.
- Most identified the initial carrying amount of \$36m but applied the effective rate to \$40m and did not apportion for six months. Most applied the rules for amortised cost valuation but deducted the 4% receivable to arrive at the carrying amount even though this had not been received. This meant that the point about it being a current asset was missed.

Part (b) – the held for sale business unit

Of all the parts to this question, this was answered the best. Many understood the impairment issue as well as how to allocate the impairment across the assets in the cash generating unit. The main point missed was the discussion of the held for sale rules and why they applied here.



Marking scheme

	Marks
(a) In line with IFRS 9 <i>Financial Instruments</i> financial assets are measured at either amortised cost or fair value, depending on the reason for holding them and the nature of the expected returns from the asset.	1
Here amortised cost should be used because Delta's objective is to hold the assets to collect the contractual cash flows, and those cash flows consist solely of the repayment of principal and interest by Epsilon.	1
The asset will initially be measured at \$36m ($\$40\text{m} \times 90\text{ cents}$).	1
The finance income for the six months to 30 September 20X3 will be \$1.782m ($\$36\text{m} \times 9.9\% \times 6/12$).	1
The closing asset will be \$37.782m ($\$36\text{m} + \1.782m).	½
This asset will be split into its current and non-current portions.	½
The interest payment due on 31 March 20X4 of \$1.6m ($\$40\text{m} \times 4\%$) will be a current asset.	1
The remaining asset of \$36.182m ($\$37.782\text{m} - \1.6m) will be non-current.	1
	<u>7</u>
(b) The business is held for sale from 1 June 20X3. The held for sale criteria apply because it is being actively marketed at a reasonable price, and the sale is expected to be completed within one year of the date of classification.	1
Given this, IFRS 5 <i>Non-current Assets Held for Sale and Discontinued Operations</i> the assets to be classified separately under current assets in the statement of financial position, and depreciation to be ceased.	1
The assets will be measured at the lower of their current carrying amounts at the date of classification, and their fair value less costs to sell. In this case, they will be re-measured to \$46m ($\$46.5\text{m} - \0.5m).	1
The impairment loss of \$17m ($\$63\text{m} - \46m) will first be allocated to goodwill, taking its carrying amount to nil.	1
None of the remaining impairment loss will be allocated to inventories or trade receivables, because their recoverable amounts are at least equal to their existing carrying amounts.	1
The remaining impairment loss of \$7m ($\$17\text{m} - \10m) will be allocated to the property, plant and equipment and the patents on a pro-rata basis.	1
The closing carrying amounts of the property, plant and equipment and the patents will be \$15m and \$6m respectively.	1
	<u>7</u>
(c) IFRS 16 includes optional recognition exceptions for short term leases and for leases of low value assets. Delta has chosen to apply these recognition exemptions.	1
Short-term leases are leases with a lease term of 12 months or less.	½
The nine-month lease of plant qualifies as a short term lease. The lease payment should be charged to profit or loss on a straight-line basis over the lease term.	1
A charge of \$40,000 ($\$180,000 \times 2/9$) should be recognised in profit or loss for the year to 30 September 20X3. The remaining lease payment of \$140,000 should be recognised as a prepayment in the statement of financial position.	1

	Marks
The four-year lease of 500 tablets is considered to be a lease of low value assets. Even though the lease of the tablet computers is material to Delta, the exemption can still be applied because the underlying assets, ie the tablets, are individually of low value.	1
The lease payments should be charged to profit or loss on a straight-line basis over the lease term.	½
A charge of \$60,000 ($\$240 \times 500 \times 6/12$) should be recorded in profit or loss, and a prepayment of \$60,000 should be recorded in the statement of financial position for the year ended 30 September 20X3.	1
	<u>6</u>
	<u>20</u>

47 Kappa 6 (12/10)

Top tips. This question should not have caused too many difficulties. IAS 33 does contain a number of fairly intricate rules, but once you know them, and are happy with performing the computations, you should be able to score well on any question in this area.

Students sometimes get put off IFRS 2, and think of it as being on par with the most difficult areas of the syllabus, such as IAS 19 or IFRS 9. Fortunately, it isn't really as tough as those areas. There are a few definite pieces of information that you need for your calculation, and you can become familiar with these by practising questions. Once you are happy with this, the principles behind the Standard are relatively simple and should be easy to explain if you have to.

Easy marks. There were plenty of marks for straightforward book knowledge in part (a).

Examining team's comments. Knowledge of the basic rules regarding the computation of basic and diluted earnings per share was generally satisfactory. The standard of calculations was rather more mixed, with many having difficulty computing the weighted average number of shares in issue in a period where a rights issue of shares has occurred.

Knowledge and application of the share-based payments rules was generally disappointing. This topic seems to have caused difficulty for candidates whenever it has been examined. **Candidates should expect to see this important standard being examined in future sittings.**

- (a) (i) IAS 33 applies to any entity disclosing earnings per share (EPS) information. This information must be disclosed by any entity whose ordinary shares or potential ordinary shares are traded in a public market.
- (ii) **Basic EPS**
Basic EPS should be computed by dividing the net profit or loss for the period attributable to ordinary shareholders (ie less any preference dividends), by the weighted average number of ordinary shares outstanding during the period (weighted by number of days).
- Diluted EPS**
Diluted EPS should be computed by adjusting the both the 'earnings' and the 'per share' figures in the calculation for the effects of all dilutive potential ordinary shares.
- Profit for the year should be adjusted for any dividends (eg preference dividends) deducted when calculating basic EPS. Any interest (eg on convertible loan stock) deducted from profit should be added back.

The number of shares used in the calculation is the weighted average if all potentially dilutive ordinary shares were converted.

(iii) **Numerical disclosures**

Disclose basic and diluted EPS on the face of the statement of profit or loss and other comprehensive income.

Disclose for each class of ordinary share with a different right to share in profit.

Disclose the amounts used as both numerators and denominators in both basic and diluted EPS.

Disclose a reconciliation of the numerators to net profit, and between the basic and diluted numbers of shares.

(iv) **Discontinuing operations**

Disclose EPS both for total profits and for profits from continuing operations, on the face of the statement of profit or loss and other comprehensive income. EPS for discontinuing operations must be disclosed, but this can be in the notes to the financial statements.

(b) **Basic EPS**

$$\text{Earnings} = \$35\text{m} - (30\text{m} \times \$0.06) = \$35\text{m} - (\$1.8\text{m}) = \$33.2\text{m}$$

Rights issue, so theoretical ex-rights price (TERP):

	\$
Before RI, 7 shares at \$1.80 each	12.60
Rights, 2 at \$1.35 each	<u>2.70</u>
	15.30
	<u>1.70</u>

$$\text{TERP} = \$15.30/9 \text{ shares} =$$

$$\text{Adjustment factor} = \text{TERP/pre-rights FV} = 1.80/1.70$$

Weighted average no. shares:

1 Oct 09 – 31 Dec 09 = $70\text{m} \times 3/12 \times 1.80/1.70 =$	18,529,412
1 Jan 10 – 30 Sep 10 = $90\text{m} \times 9/12 =$	<u>67,500,000</u>
	86,029,412

$$\text{Basic EPS} = \$33.2\text{m}/86,029,412 = 38.6\text{c}$$

Diluted EPS

Need to adjust earnings for post-tax loan interest at effective rate, and number of shares for potential issue of 20m (ratio 1:1).

$$\text{Earnings} = \$33.2\text{m} + ((\$23\text{m} \times 7\%) \times 80\%) = \$34,488,000$$

$$\text{Shares} = 86,029,412 + 20\text{m} = 106,029,412$$

$$\text{Diluted EPS} = \$34,488,000/106,029,412 = 32.5\text{c}$$

- (c) The cumulative amount recognised at 30 September 20X7 is $500 \times 200 \times \$1.20 \times 2/3 = \$80,000$. This is shown in the statement of financial position as part of equity.

The cumulative amount recognised at 30 September 20X6 is $500 \times 150 \times \$1.20 \times 1/3 = \$30,000$.

Therefore the amount recognised in the SPLOCI for the year is \$50,000 (\$80,000 – \$30,000).



48 Townsend

(a) Year ended 31 March 20X4

Date	Narrative	Shares	Time	Bonus fraction	Weighted average
1.4.X3	Opening	40,000,000	$\times \frac{3}{12}$	$\times \frac{5}{4}$	12,500,000
1.7.X3	Full market price	<u>8,000,000</u>			
		48,000,000	$\frac{6}{12}$	$\times \frac{5}{4}$	30,000,000
1.1.X4	Bonus issue ($\frac{1}{4}$)	<u>12,000,000</u>	$\frac{3}{12}$		<u>15,000,000</u>
		60,000,000			<u>57,500,000</u>

Earnings \$13.8m, therefore $\text{EPS} = 13.8/57.5 = 24\text{c}$

Comparative

The EPS for 20X3 would be restated to allow for the effect of the bonus issue as follows:

$$25\text{c} \times 48/60^* = 20\text{c}$$

- * Existing shares + new issue = 48
Existing shares + new issue + bonus issue = 60

Year ended 31 March 20X5

'2 for 5' rights issue takes place halfway through the year and results in 24m additional shares.

Weighted average number of shares calculated as follows:

Date	Narrative	Shares	Time	Bonus fraction	Weighted average
1.4.X4	Opening	60,000,000	$\frac{6}{12}$	$2.4\frac{1}{2}(\text{W})$	36,000,000
30.9.X4	Rights issue ($\frac{2}{5}$)	<u>24,000,000</u>			
		84,000,000	$\frac{6}{12}$		<u>42,000,000</u>
					<u>78,000,000</u>

Earnings \$19.5m, therefore $\text{EPS} = 19.5/78 = 25\text{c}$

Comparative

The EPS for 20X4 is now restated following the rights issue in October 20X4 as follows:

$$24\text{c} \times \text{Theoretical ex-rights price (W)/Market price} = 24\text{c} \times 2/2.40 = 20\text{c}$$

Working

		\$
<i>Theoretical ex-rights price</i>		
5 shares at market price (5×2.4)	5 @ \$2.4	12
2 shares at \$1	2 @ 1	<u>2</u>
	<u>7</u>	<u>14</u>

$$\therefore \text{Theoretical ex-rights price} = \$14/7 = \$2$$



- (b) Basic EPS = $\$25.2\text{m}/84\text{m} = 30\text{c}$

We must decide which, if any, of the potential ordinary shares are dilutive:

Loan stock

Incremental EPS: $1.8\text{m (W1)}/5.0\text{m} = 36\text{c}$; this is higher than basic EPS therefore the loan stock is not dilutive and is not included in the calculation of diluted EPS.

Share options

Shares issued will be $12\text{m} @ \$1.50 = \18m .

At market price of $\$2.50$ the value would be $\$30\text{m}$.

The shortfall is $\$12\text{m}$, which is equivalent to 4.8m shares at market price. The share options are dilutive as 4.8m shares are deemed to have been issued for no consideration.

$$\text{Diluted EPS} = 25.2 / (84.0 + 4.8) = 28.4\text{c}$$

Workings

1 *Loan stock*

	\$m
When conversion takes place there will be a saving of:	
Interest ($20\text{m} \times 10\%$)	2.0
Less tax ($2.0 \times 20\%$)	(0.4)
	<u>1.8</u>

- (c) **Basis of basic EPS**

Some might say that it is misleading to calculate basic EPS without taking into account **financial instruments** that will enable their holder to become a shareholder. Because of the 'quasi-equity' nature of these financial instruments and the likelihood that holders of such securities will exercise their right to convert, basic EPS might be said to be a meaningless statistic if it is not adjusted for these elements.

One potential problem with this method is that the definitions of 'share equivalents' would need to be quite precise. If this was not the case then the basic EPS would not be comparable between companies. This method also assumes that the likelihood of the conversion of the **share equivalent** is the same for all companies. The key test would probably be whether the holder of the financial instrument has an expectation of sharing in any increase in the value of the shares. A fall in the value of the shares might affect the likelihood of conversion and thus cause the EPS in this event to be unrealistic.

A problem with this approach is that the basic undiluted EPS will not be shown. It is probably most useful to users if **several statistics** are shown, eg the basic EPS, the diluted EPS showing maximum dilution and the diluted EPS showing the effects of all dilution.

49 RP Group

[References: IAS 24: paras. 4, 9, 11]

Tutorial note. The DipIFR examining team have stated that you would be unlikely to be set a complete question of this length on this issue – it would be more likely to be examined as part of a question.

(a) (i) **Importance of related party disclosures**

Related party relationships (RP) are part of normal business activity. RP exist for **sound commercial reasons** and often have a **material impact** on the financial position of companies. **Inter-company trading between members of a group is a common example.**

However, the existence of RP should be disclosed in order that **users appreciate** that not all transactions have been undertaken '**at arms' length**'. Users will expect that, in the absence of disclosure of the details of an RP, all the transactions have been undertaken at arms' length.

Even if there are no transactions between RP the results of a group can still be affected by the relationship. For example, a newly acquired subsidiary can be compelled to finish a trading relationship with another company in order to benefit other group companies.

(ii) **Situation regarding small companies**

Disclosure of RP details is **equally important** to the users of small company accounts as it is for large companies.

If the RP transaction involves individuals who have an interest in a small company then the **significance** of the RP transaction **could be disproportionately high** because of the **degree of influence** exercised by the **individual concerned**. While the cost of providing RP disclosures is difficult to evaluate, it is likely that normal cost benefit considerations should not apply to these in view of the **potential benefits to users of full disclosure**.

Many countries legislative systems which require disclosure of related party matters, however these disclosures only give limited assurance to users. **IAS 24 Related Party Disclosures** extends these requirements to give a **comprehensive** disclosure package and attempts to achieve a **measure of consistency between country reporting systems**.

(b) **Disclosure requirements**

- (i) IAS 24 does not require disclosure of transactions between companies and providers of finance in the ordinary course of business. As RP is an investment bank, no disclosure is needed between RP and AB. However, RP owns 25% of the equity of AB and it would seem significant influence exists (IAS 28, **greater than 20% existing holding means significant influence is presumed**) and therefore AB could be associate of RP. IAS 24 regards associates as related parties.

The decision as to associate status depends upon the ability of RP to exercise significant influence especially as the other 75% of votes are owned by the management of AB.

IAS 28 presumes that a party owning or able to exercise control over 20% of voting rights is an associate. So an investor with a 25% holding and a director on the board would be expected to have significant influence over operating and financial policies in such a way as to inhibit the pursuit of separate interests. If it can be shown that this is not the case, there is no related party relationship.

If it is decided that there is a related party situation then **all material transactions** should be disclosed including **management fees, interest, dividends and the terms of the loan**.

- (ii) **IAS 24 does NOT require intra-group transactions and balances eliminated on consolidation to be disclosed.** IAS 24 does deal with the situation where an entity becomes, or ceases to be, a subsidiary during the year.

Best practice indicates that related party transactions should be disclosed for the period when X was not part of the group. Transactions between RP and X should be disclosed between 1 July 20X9 and 31 October 20X9 but transactions prior to 1 July will have been eliminated on consolidation.

There is no related party relationship between RP and Z since it is a normal business transaction unless either parties interests have been influenced or controlled in some way by the other party.

50 Omega (6/13)

Top tips. This question required you to play the role of the knowledgeable old hand to the uninformed managing director, which may have been a pleasant part to play.

Part (a) may have been harder than part (b), depending on how familiar you were with the standards in question. This question is testament to the importance of knowing the technical material.

Easy marks. Part (b) contained some easy marks for stating the basic requirements of IFRS 8.

Examining team's comments. This question (more 'essay type' in style) required candidates to describe the main provisions of two International Financial Reporting Standards IFRS 13 *Fair Value Measurement* and IFRS 8 *Operating Segments*.

Answers to the IFRS 13 part were very polarised. Some candidates had clearly read the (relatively new) standard and scored good marks. Others clearly had not, and so failed to gain many marks. This shows the importance of keeping up to date in this exam.

Most candidates seemed aware of the main principles of IFRS 8 although not all stated that it only applies to listed entities. Many were unsure on how to apply the '10% limits'.

[References: IFRS 8: paras. 5–7, 11–13; IFRS 13: paras. 9, 72–90]

Marking scheme

	Marks
(a) Although it is true that the majority of assets and liabilities that are recognised in financial statements are measured based on their original cost, there are a number that are measured at fair value. Three examples of the use of the 'fair value basis' are:	
The assets and liabilities of a newly acquired subsidiary are measured in the consolidated financial statements at their fair values at the date of acquisition.	1
Many financial instruments are measured at fair value.	1
Property, plant and equipment can be measured at fair value on a class by class basis.	1
Tutorial note. Other valid examples – eg investment properties or biological assets – would also receive credit.	
IFRS 13 <i>Fair Value Measurement</i> defines fair value as the amount that would be received to sell an asset, or paid to transfer a liability , in an orderly transaction between market participants .	$\frac{1}{2} + \frac{1}{2}$ $+ \frac{1}{2} + \frac{1}{2}$
The IFRS 13 definition removes the uncertainty that was previously an issue in that it confirms that fair value is an exit measure, not an entry measure.	$\frac{1}{2}$



Marks

The fair value hierarchy refers to three levels of input into the measurement of fair value. These three levels vary in their reliability, starting with the most reliable and ending with the least reliable:

Level 1 inputs are market prices where the asset or liability is quoted in an active market. These inputs are given the highest priority when measuring fair values and are not normally subject to any adjustment. An example would be the use of quoted prices to measure the fair value of equity instruments.

1½

Level 2 inputs are inputs into the calculation of fair value that, whilst not market values, are observable to an external user. An example would be the quoted prices of shares in similar entities when measuring the fair value of an unquoted share. Level 2 inputs are sometimes adjusted to reflect differential circumstances.

1½

Level 3 inputs are those that are not observable to an external user. An example would be the assumptions regarding future profits when measuring the fair value of an unquoted share. When measuring fair values, use of Level 3 inputs should be kept to a minimum.

1½
10

- (b) A reportable segment is an operating segment that satisfies certain materiality criteria.

½

An operating segment is a component of an entity:

- That engages in business activities from which it may earn revenues and incur expenses.
- Whose operating results are regularly reviewed by the Chief Operating Decision Maker (CODM).
- For which discrete financial information is available.
- The CODM is a **function**, not a title. The function is to make decisions about **allocating resources** and **assessing performance**.

½ + ½

½ + ½

½

½ + ½ + ½

The materiality criteria are any one of the following:

½

- Reported revenue is 10% or more of the total revenue of all operating segments.
- The **absolute amount of its reported profit or loss** is 10% or more of the greater of the **combined reported profit** of all the profit making segments and the **combined reported loss** of all the segments that reported a loss.
- Total assets are 10% or more of the total assets of all operating segments.

½

½ + ½ + ½

½

Two or more operating segments that exhibit **similar economic characteristics** can be combined into a **single operating segment** for reporting purposes.

½ + ½

Even if an operating segment does not meet any of the quantitative thresholds, it can be considered reportable if management believes that information about that segment would be useful to users of the financial statements.

½

As a minimum, the total external revenue of reportable segments should be at least 75% of total entity revenue. If this is not achieved by applying the size criteria to individual segments, **additional reportable segments need to be added until this threshold is achieved.**

½ + ½
10
20



51 Omega (12/14)

Top tips. This was a typical discursive question, requiring you to explain three different issues to a non-accountant. Part (a) (possibly the most difficult, if you had not prepared this topic) concerned segment reporting (IFRS 8).

Part (b) asked you to explain the way in which equity settled share-based payments are treated in the financial statements. Here it was important not to waste time explaining **why** there is a charge to profit or loss. Read the query carefully to see what the managing director actually wants to know.

Part (c) focuses on the basic requirements of IFRS 5.

Easy marks. You should have been able to score almost full marks on part (c), and if you had revised that topic, there were also some easy marks for stating the basic requirements of IFRS 2 regarding the treatment of equity settled share based payment.

Examining team's comments. Candidates did not answer part (a) very well. A significant number of candidates were unaware of any of the requirements of the international financial reporting standard on segment reporting – IFRS 8. Many such candidates made reference to IAS 14 – the predecessor standard to IFRS 8. It has already been stated in this report that candidates need to keep their knowledge up to date and it appears that further attention is required to new standards. Another factor in part (a) was that many candidates did not address the requirements of the question specifically enough. The question asked why the segment reports of two apparently similar entities could be so different. A number of candidates did not really attempt to address this issue, but simply defined the meaning of an operating segment and (in some cases at least) the relevant requirements of IFRS 8. Answers to part (b) were generally of a satisfactory standard but a significant minority of candidates wasted time by making references to cash-settled share-based payments. These were not part of the requirement so, whilst the comments were in many cases correct, they did not score marks. Once again the message here is that candidates must focus carefully on the exact requirements of each question. Answers to part (c) were generally satisfactory.

[References: IFRS 2: paras. 2, 7–8, 14; IFRS 5: paras. 6–8, 15, 18, 20–22, 25, 38; IFRS 8: paras. 5, 7, 23]

Marking scheme

Marks

Query One

It is true that there is an International Financial Reporting Standard (IFRS) which deals with operating segments and lays down the content of segmental reports (**concept**). The relevant standard is IFRS 8 *Operating Segments*.

½

However, differences between the segment reports of organisations will arise from how segments are identified and what exactly is reported for each segment (**concept**).

½ + ½

IFRS 8 defines an operating segment as a component of an entity which engages in revenue earning activities and whose results are regularly reviewed by the **chief operating decision maker (CODM)**.

½ + ½

The CODM is the **individual, or group of individuals**, who makes decisions about **segment performance** and **resource allocation**.

½ + ½ + ½

This definition means that the operating segments of apparently similar organisations could be identified very differently, with a consequential impact on the nature of the report.

½

As stated above, differences also arise due to the reporting requirements for each segment. IFRS 8 requires that 'a measure' of profit or loss is reported for each segment. However, the **measurement of revenues and expenses which are used in determining profit or loss is based on the principles used in the information the CODM sees**. This is so, **even if these principles do not correspond with IFRS**. This could clearly cause differences between reports from apparently similar organisations.

½ + ½ + ½ + ½



Marks

Additionally, IFRS 8 requires a measure of total **assets** and **liabilities** by operating segment if the **CODM sees this information**. Since **some CODMs may see this information and some may not**, this could once again cause differences between the reports of apparently similar organisations.

$$\frac{\frac{1}{2} + \frac{1}{2} + \frac{1}{2}}{8}$$

Query Two

An equity-settled share-based payment transaction is one in which an entity receives goods or services in exchange for a right over its equity instruments.

1/2

Where the payments involve the granting of share options, IFRS 2 *Share-based Payment* requires that the payments are measured at the **fair value** of the options at the **grant date**. No change is made to this measurement when the fair value **changes after the grant date**.

$$\frac{1}{2} + \frac{1}{2} + \frac{1}{2}$$

Unless the entity has traded options which have exactly the same terms and conditions as those granted to employees (unlikely), then fair value is estimated using an option pricing model.

1/2

The first step in accounting for such payments is to estimate the total expected cost of the share-based payment.

1/2

This estimate takes account of any **conditions** attaching to the options vesting (**the employees becoming unconditionally entitled to exercise them**) other than **market** conditions (those based on the future share price, which are taken account of in estimating the fair value of the option at the grant date).

$$\frac{1}{2} + \frac{1}{2} + \frac{1}{2}$$

The total expected cost is recognised in the financial statements over the vesting period (ie the period from the grant date to the vesting date).

1/2

In the case of options granted to employees, the debit entry would be recorded as **remuneration** expense. Normally this would mean the debit entry being shown in the statement of **profit or loss** but in theory the debit entry could be an asset depending on the work of the employee involved.

$$\frac{1}{2} + \frac{1}{2}$$

The credit entry is taken to **equity**. IFRS 2 is **silent** as to which component of equity this should be – normally it would be to an option reserve.

$$\frac{1}{2} + \frac{1}{2}$$

The above treatment is **unaffected** by whether or not employees subsequently exercise vested options. **If they do**, then the entity debits cash and credits equity with the cash proceeds.

$$\frac{\frac{1}{2} + \frac{1}{2}}{8}$$

Query Three

A non-current asset is classified as held for sale when its carrying amount will be recovered principally through a sale transaction, rather than through continuing use.

1

Such assets are measured at the lower of their **carrying amount** and **fair value less costs to sell**. Any write downs arising out of this process are treated as **impairment losses**.

$$\frac{1}{2} + \frac{1}{2} + \frac{1}{2}$$

The 'held for sale' definition can apply to **groups of assets** as well as single assets where the group of assets is to be sold as a **single unit**. It is in situations **such as this** that liabilities associated with such groups of assets are separately identified.

$$\frac{\frac{1}{2} + \frac{1}{2} + \frac{1}{2}}{4}$$

20



52 Whitebirk

BPP Study Text reference. Small and medium-sized entities are covered in Chapter 19 of your BPP Study Text.

Top tips. This is a topical issue. Part (a) on the different approaches which could have been used and the main differences between the *IFRS for SMEs* and full IFRS, was reasonably straightforward. Part (b) required you to apply the standard to specific areas: goodwill and research and development expenditure.

Easy marks. This was a rich source of easy marks for the well-prepared candidate. Make sure your arguments are well-structured in order to earn those two marks for clarity and quality of discussion.

[References: IFRS for SMEs: paras. 18.4, 18.14, 19.22–23]

(a) (i) **Approaches which the IASB could have taken in developing the IFRS for SMEs**

There were three main approaches which the IASB could have taken in developing the *IFRS for Small and Medium-sized Entities (IFRS for SMEs)*.

(1) **National GAAP for SMEs and IFRS for listed companies**

It could be argued that small and medium-sized entities have little in common with larger listed entities and that listed entities have more in common with listed entities in other developed countries. It would therefore be appropriate for listed companies to use IFRS and for smaller entities to have their own national 'little GAAP'.

The **disadvantage** of this approach is the **inconsistency** within countries between 'big GAAP' and 'little GAAP'. This would make comparability difficult. Further, if an SME, having applied national GAAP for SMEs for some time, wished to list its shares on a capital market, the **transition to IFRS** would be even more **onerous** than it is currently.

(2) **Exemptions for SMEs within existing standards**

Another approach would be exemptions for smaller companies from some of the requirements of existing standards, and for these exemptions to be contained within IFRS, probably as an appendix.

This approach has the **disadvantage** that preparers of small company financial statements would still need to look through mainstream IFRS to determine what they did not need to do. Arguably this is **far less convenient** than having a 'stand-alone' standard designed for SMEs.

(3) **A separate set of standards only relevant for SMEs**

This is closest to what actually happened, but it is not as convenient as having one standard as a one-stop shop. It would have resulted in a proliferation of accounting standards, adding to an already complex picture.

In the event, none of the above approaches was followed. Instead the *IFRS for SMEs*, published in July 2009, is a self-contained document. It is the first set of international accounting requirements developed specifically for small and medium-sized entities. Although it has been **prepared on a similar basis to IFRS**, it is a **stand-alone product** and will be updated on its own timescale.

(ii) **Modifications to reduce the burden of reporting for SMEs**

The *IFRS for SMEs* is only 230 pages, and has **simplifications** that reflect the needs of users of SMEs' financial statements and cost-benefit considerations. It is designed to facilitate financial reporting by small and medium-sized entities in a number of ways:

- (1) It provides significantly **less guidance** than full IFRS. A great deal of the guidance in full IFRS would not be relevant to the needs of smaller entities.



- (2) Many of the **principles** for recognising and measuring assets, liabilities, income and expenses in full IFRSs are **simplified**. For example, goodwill and intangibles are always amortised over their estimated useful life (or ten years if it cannot be estimated). Research and development costs must be expensed. Government grants are recognised as income in full when receivable.
- (3) Where full IFRSs allow accounting policy choices, the *IFRS for SMEs* allows **only the easier option**. Examples of alternatives not allowed in the *IFRS for SMEs* include: revaluation model for intangible assets and choice between cost and fair value models for investment property.
- (4) **Topics not relevant** to SMEs are **omitted**: earnings per share, interim financial reporting, segment reporting, and insurance.
- (5) Significantly **fewer disclosures** are required.
- (6) The standard has been written in **clear language** that can easily be translated.

The above represents a considerable reduction in reporting requirements – perhaps as much as 90% – compared with listed entities. Entities will naturally wish to use the *IFRS for SMEs* if they can, but **its use is restricted**.

The restrictions are **not related to size**. There are several disadvantages of basing the definition on size limits alone. Size limits are **arbitrary** and **different limits are likely to be appropriate in different countries**. Most people believe that SMEs are **not simply smaller versions of listed entities**, but differ from them in more fundamental ways.

The most important way in which SMEs differ from other entities is that they are **not usually publicly accountable**. Accordingly, there are **no quantitative thresholds** for qualification as a SME; instead, the scope of the IFRS is determined by a **test of public accountability**. The IFRS is suitable for all entities except those whose securities are publicly traded and financial institutions such as banks and insurance companies.

Another way in which the use of the *IFRS for SMEs* is restricted is that **users cannot cherry pick** from this IFRS and full IFRS. If an entity adopts the *IFRS for SMEs*, it **must adopt it in its entirety**.

(b) (i) **Business combination**

IFRS 3 *Business Combinations* allows an entity to adopt the full or partial goodwill method in its consolidated financial statements. The *IFRS for SMEs* **only allows the partial goodwill method**. This avoids the need for SMEs to determine the fair value of the non-controlling interests not purchased when undertaking a business combination.

In addition, IFRS 3 *Business Combinations* requires goodwill to be tested annually for impairment. The *IFRS for SMEs* **requires goodwill to be amortised instead**. This is a much simpler approach and the *IFRS for SMEs* specifies that if an entity is unable to make a reliable estimate of the useful life, it is presumed to be ten years, simplifying things even further.

Goodwill on Whitebirk's acquisition of Close will be calculated as:

	\$'000
Consideration transferred	5,700
Non-controlling interest: 10% × \$6m	600
	<u>6,300</u>
Less fair value of identifiable net assets acquired	<u>(6,000)</u>
Goodwill	<u>300</u>

This goodwill of \$0.3m will be amortised over ten years, that is \$30,000 per annum.

(ii) **Research and development expenditure**

The *IFRS for SMEs* requires all internally generated research and development expenditure to be **expensed through profit or loss**. This is simpler than full IFRS – IAS 38 *Intangible Assets* requires internally generated assets to be capitalised if certain criteria (proving future economic benefits) are met, and it is often difficult to determine whether or not they have been met.

Whitebirk's total expenditure on research (\$0.5m) and development (\$1m) must be written off to profit or loss for the year, giving a charge of \$1.5m.

53 Alpha Group 10 (6/12)

Top tips. This is a tough question, with a large number of adjustments to keep track of, which can be intimidating when you first read the question. Set up your proforma and work through the adjustments in order, referencing and showing your workings clearly – both for the benefit of the marker and yourself. You should be able to deal with each of the individual issues:

- Test goodwill on acquisition of subsidiary for impairment
- Deferred consideration
- Foreign currency liability
- Defined benefit retirement plan
- Fundamental accounting requirements for consolidation of subsidiaries and associates

Easy marks. As with most groups questions, there are easy marks for slotting the simpler figures into the statement of financial position, or for some simple addition.

Examining team's comments. On the whole the presentation of the statement of financial position was good and the workings were clearly labelled and easy to follow.

There was poorer performance in the accounting for the loan and accounting for property, plant and equipment.

Marking scheme

		Marks
CONSOLIDATED STATEMENT OF FINANCIAL POSITION OF ALPHA AT 31 MARCH 20X2		
Assets	\$'000	
<i>Non-current assets</i>		
Property, plant and equipment (267,000 + 250,000 + 4,800 (W1) – 20,000 (W1) – 5,000 (W10))	496,800	½ + ½ + ½
Goodwill (W2)	77,759	7 (W2)
Investment in joint venture (W6)	71,000	1½ (W6)
	<u>645,559</u>	
<i>Current assets</i>		
Inventories (85,000 + 50,000 – 3,000 (W5))	132,000	½ + ½
Trade receivables (75,000 + 45,000 – 8,000 (intra-group))	112,000	½ + ½
Cash and cash equivalents (15,000 + 10,000)	25,000	½
	<u>269,000</u>	
Total assets	<u>914,559</u>	
	\$'000	
Equity and liabilities	\$'000	
<i>Equity attributable to equity holders of the parent</i>		
Share capital	195,000	½
Retained earnings (W5)	303,358	19½ (W5)
	<u>498,358</u>	
Non-controlling interest (W4)	58,812	2 (W4)
Total equity	<u>557,170</u>	

		Marks
Non-current liabilities:		
Deferred consideration (W7)	68,181	½
Pension liability (W8)	66,000	½
Long-term borrowings (63,049 (W9) + 45,000)	108,049	½ + ½
Deferred tax (W11)	32,159	2 (W10)
Total non-current liabilities	<u>274,389</u>	
Current liabilities:		
Trade and other payables (35,000 + 30,000 – 8,000 (intra-group))	57,000	½ + ½
Short-term borrowings (16,000 + 10,000)	26,000	½
Total current liabilities	<u>83,000</u>	<u>40</u>
Total equity and liabilities	<u>914,559</u>	

Workings – Do not double count marks

1 Net assets table – Beta

	1 April 20X0 \$'000	31 March 20X2 \$'000	For W2	For W5
Share capital	100,000	100,000	½	
Retained earnings:				
Per accounts of Beta	45,000	100,000	½	½
Plant and equipment adjustment – see below	10,000	4,800	½	½
Inventory adjustment	3,000	Nil	½	½
Other components of equity:				
Per accounts of Beta	35,000	55,000	½	½
Reversal of post-acquisition revaluation		(20,000)	½	
Deferred tax on fair value adjustments	(2,600)	(960)	½ (W9)	½ (W9)
Net assets for the consolidation	<u>190,400</u>	<u>238,840</u>		

The post-acquisition increase in net assets is \$48.44m (\$238.84m – \$190.4m).

All of this relates to retained earnings

1

Note re: post-acquisition plant and equipment adjustment:

This is \$4.8m (\$10m × 3/5 × 80%).

2 Goodwill on consolidation (Beta)

	\$'000	
Cost of investment:		
Share exchange (75 million × 2/3 × \$3.50)	175,000	½
Deferred consideration (75 million × \$1)/(1.10)3	56,349	1
Fair value of non-controlling interest at date of acquisition (25 million × \$2.00)	<u>50,000</u>	½
	281,349	
Net assets at 1 April 20X0 (W1)	<u>(190,400)</u>	3 (W1)
Goodwill before impairment	90,949	
Impairment (W3)	<u>(13,190)</u>	2 (W3)
Goodwill after impairment	<u>77,759</u>	<u>7</u>

3 Impairment of goodwill

	\$'000	
Carrying amount of assets in cash generating unit	70,000	½
Allocated goodwill (1/(2 + 1 + 1 + 1)% × \$90.949m (W2))	<u>18,190</u>	1
	88,190	
Recoverable amount of assets in cash generating unit	<u>(75,000)</u>	½
So impairment equals	<u>13,190</u>	<u>2</u>
		⇒W2

		Marks
4	<i>Non-controlling interest in Beta</i>	
	Fair value at date of acquisition (W2)	50,000 ½
	25% of post-acquisition increase in net assets (\$48.44m (W1))	12,110 1
	25% of goodwill impairment (\$13.19m – (W3))	(3,298) ½
		<u>58,812</u> 2
5	<i>Retained earnings</i>	
		\$'000
	Alpha	281,167 ½
	Additional finance cost for deferred consideration (W6)	(6,198) 1½ (W7)
	Adjustment for pension liability (W7)	(31,000) 5½ (W8)
	Adjustment for carrying amount of loan (W8)	(3,049) 4 (W9)
	Beta (75% × \$48.44m (W1))	36,330 ½ + 4
		(W1)
	Gamma (40% × 100,000)	40,000 1
	Unrealised profits on sales to Beta (15,000 × 25/125)	(3,000) 1
	Unrealised profits on sales to Gamma (12,500 × 25/125 × 40%)	(1,000) 1
	75% of goodwill impairment (\$13.19m – (W3))	(9,892) ½
		<u>303,358</u> 19½
6	<i>Investment in Gamma</i>	
	Cost	32,000 ½
	Share of post-acquisition profits (W5)	40,000 ½
	Unrealised profits on sales to Gamma (W5)	(1,000) ½
	At 31 March 20X2	<u>71,000</u> 1½
7	<i>Deferred consideration</i>	
	At 1 April 20X1 – two years to payment	61,983 1
	Finance cost for the current year (10%)	6,198 ½
	At 31 March 20X2	<u>68,181</u> 1½
		⇒ W5
8	<i>Net pension liability</i>	
		\$'000
	At 1 April 20X1	60,000 ½
	Current service cost	28,000 ½
	Net interest cost	2,000 ½
	Contributions paid by Alpha	(25,000) ½
	Benefits paid by plan (cancel out)	nil ½
	Actuarial differences	1,000 1
	At 31 March 20X2	<u>66,000</u> ½
	As per draft financial statements of Alpha (\$60m (brought forward) minus \$25m (contributions in the period))	(35,000) 1
	So adjustment equals	<u>31,000</u> ½
		5½
		⇒ W5

			Marks
9	<i>Long-term borrowings in foreign currency</i>		
	Opening carrying amount in €'000	49,000	1
	Finance cost for the current period (11.1%)	5,439	1
	Interest actually paid	(4,000)	½
	So closing carrying amount in €s	50,439	
	Translated into \$'000 at the closing rate (\$1.25 to €1)	63,049	1
	As per draft financial statements of Alpha	(60,000)	½
	So closing adjustment equals	3,049	
		<u>4</u>	
		⇒W5	
10	<i>Deferred tax on temporary differences</i>		
	Fair value adjustments:		
		1 April 20X0	31 March 20X2
		\$'000	\$'000
	Plant and equipment adjustment	10,000	4,800
	Inventory adjustment	3,000	Nil
	Net taxable temporary differences	13,000	4,800
	Related deferred tax (20%)	2,600	960
			<u>1</u>
			⇒W1
11	<i>Closing deferred tax</i>		
		\$'000	
	Alpha + Beta	36,199	½
	On fair value adjustments (W9)	960	½
	Reversal of deferred tax on post-acquisition property revaluation of Beta (55,000 – 35,000) × 20/80	(5,000)	1
		<u>32,159</u>	<u>2</u>

54 Alpha (6/13)

Top tips. The group accounting question is always a tough one, covering a number of different topics, and with a lot of adjustments to keep track of. This can be off-putting when you first read the question, so make sure you have a plan to get started. The first thing to do is to set up your proforma. Then work through the adjustments in the order they appear in the question. Reference your calculations and show your workings clearly. This is for your benefit as well as for the marker. You will probably find that if you take each issue individually, you know how to deal with each one:

- Acquisition of a subsidiary with a deferred consideration
- Fair value adjustments on subsidiary
- Intercompany sale of inventories and intercompany balances
- Share-based payment
- Discounted provision
- Long-term borrowings

Easy marks. As with most groups questions, there are easy marks for slotting the simpler figures into the statement of financial position, or for some simple addition.

Examining team's comments.*Areas showing good knowledge:*

- Good formats which were mostly complete.
- Calculations for goodwill were often correct.
- The basic adjustments for deferred tax, fair value of net assets on acquisition and inter-company balances were dealt with correctly.
- Calculations for the share based payment and provision adjustments.

Areas where mistakes were common:

- Deducting the unrealised profit for the associate as well as the subsidiary from the inventories.
- Forgetting to include the contingent consideration liability in the statement of financial position.
- Many candidates forgot to do anything with the other components of equity – perhaps Alpha's was included but little else.
- Although many knew that the provision needed adjustment and calculated the provision correctly, many forgot to debit property, plant and equipment and make the appropriate adjustments to depreciation.
- For the financial liability many candidates added the transaction cost to the liability instead of deducting it.
- For the investment in Gamma (the associate) many candidates forgot to add the share of the post-acquisition change in other components of equity.

Marking scheme**Marks**

**CONSOLIDATED STATEMENT OF FINANCIAL POSITION OF ALPHA FOR THE YEAR ENDED
31 MARCH 20X3**

	\$'000	
Assets		
<i>Non-current assets</i>		
Property, plant and equipment (280,000 + 225,000 + 19,250 (W1) + 6,000 (W1) + 6,120 (W7))	536,370	½ + ½ + ½ + ½
Right-of-use assets	108,000	½
Intangible assets (W1)	6,000	½
Goodwill (W2)	89,000	6½ (W2)
Investment in Gamma	77,120	2 (W9)
Other Investments	40,000	½
	<u>856,490</u>	
<i>Current assets</i>		
Inventories (85,000 + 56,000 – 3,500 (W4))	137,500	½ + ½
Trade receivables (70,000 + 42,000 – 9,000 (intra-group) – nil (associate))	103,000	½ + ½
Cash and cash equivalents (14,000 + 11,000)	25,000	½
	<u>265,500</u>	
Total assets	<u>1,013,990</u>	

Marks

CONSOLIDATED STATEMENT OF FINANCIAL POSITION OF ALPHA FOR THE YEAR ENDED
31 MARCH 20X3

	\$'000	
Equity and liabilities		
<i>Equity</i>		
Share capital (160,000 + 80,000 (shares issued to acquire Beta))	240,000	1
Retained earnings (W4)	220,201	15 (W4)
Other components of equity (W5)	147,752	4½ (W5)
	<u>607,953</u>	
Non-controlling interest (W3)	84,500	1 (W3)
Total equity	<u>692,453</u>	
<i>Non-current liabilities</i>		
Contingent consideration	28,000	½
Provisions (W7)	7,387	½
Lease liability	103,000	½
Long-term borrowings (60,000 + 50,000 + 900 (W8))	110,900	½
Deferred tax (22,000 + 25,000 + 6,250 (W10))	53,250	½
Total non-current liabilities	<u>302,537</u>	
<i>Current liabilities</i>		
Lease liability	9,000	½
Trade and other payables (45,000 + 40,000 – 9,000 (intra-group) – nil (associate))	76,000	½
Short-term borrowings (22,000 + 20,000)	42,000	½
Total current liabilities	<u>127,000</u>	40
Total equity and liabilities	<u>1,013,990</u>	

Workings – Do not double count marks

1 Net assets table – Beta

	1 April 20X2 \$'000	31 March 20X3 \$'000	For W2	For W4
Share capital	120,000	120,000	½	
Other components of equity	2,400	4,000	½	½
Retained earnings:				
Per accounts of Beta	86,000	115,000	½	½
Property adjustment	20,000	20,000	½	
Extra depreciation ((92,000 – 80,000)/16)		(750)		½
Plant and equipment adjustment	9,000	9,000	½	
Extra depreciation ((120,000 – 111,000)/3)		(3,000)		½
Intangible asset adjustment	8,000	8,000	½	
Extra amortisation (8,000/4)		(2,000)		½
Deferred tax on fair value adjustments	(7,400)	(6,250)	1 (W10)	1 (W10)
Net assets for the consolidation	<u>238,000</u>	<u>264,000</u>		
The post-acquisition increase in net assets is 26,000 (264,000 – 238,000). 1,600 of this increase relates to other components of equity and the balance (24,400) relates to retained earnings.				1

4
⇒ W2 4½
⇒ W4

		Marks
2	<i>Goodwill on consolidation (Beta)</i>	
	\$'000	
Consideration transferred:		
Share exchange (90 million \times 8/9 \times \$2.80)	224,000	1
Contingent consideration	<u>25,000</u>	$\frac{1}{2}$
	249,000	
Fair value of non-controlling interest at date of acquisition (30 million \times \$2.60)	<u>78,000</u>	1
	327,000	
Net assets at 1 April 20X2 (W1)	<u>(238,000)</u>	4 (W1)
Goodwill	<u>89,000</u>	$6\frac{1}{2}$
3	<i>Non-controlling interest in Beta</i>	
	\$'000	
Fair value at date of acquisition (W2)	78,000	$\frac{1}{2}$
25% of post-acquisition increase in net assets (26,000 (W1))	<u>6,500</u>	$\frac{1}{2}$
	<u>84,500</u>	<u>1</u>
4	<i>Retained earnings</i>	
	\$'000	
Alpha	207,396	$\frac{1}{2}$
Adjustment to fair value of contingent consideration (28,000 – 25,000)	(3,000)	$\frac{1}{2}$
Adjustment for share based payment (W6)	(1,128)	$1\frac{1}{2}$ (W6)
Adjustment for provision (W7)	233	$3\frac{1}{2}$ (W7)
Adjustment for carrying amount of loan (W8)	(900)	$1\frac{1}{2}$ (W8)
Beta (75% \times 24,400 (W1))	18,300	$\frac{1}{2} + 4\frac{1}{2}$ (W1)
Gamma (40% \times (76,000 – 66,000))	4,000	$\frac{1}{2}$
Unrealised profits on sales to Beta (14,000 \times 1/4)	(3,500)	1
Unrealised profits on sales to Gamma (12,000 \times 1/4 \times 40%)	<u>(1,200)</u>	<u>1</u>
	<u>220,201</u>	<u>15</u>
5	<i>Other components of equity</i>	
	\$'000	
Alpha	5,604	$\frac{1}{2}$
Premium on issue of shares to acquire Beta (80 million \times \$1.80)	144,000	1
Reversal re: investment in Gamma	(4,500)	1
Adjustment re: share based payment (W6)	1,128	$\frac{1}{2}$
Beta (75% \times 1,600 (W1))	1,200	1
Gamma (40% (2,000 – 1,200))	<u>320</u>	$\frac{1}{2}$
	<u>147,752</u>	<u>4\frac{1}{2}</u>
6	<i>Share based payment</i>	
	\$'000	
Expected total cost (9.3 million \times \$0.36)	3,348	$\frac{1}{2}$
Cumulative cost recognised to 31 March 20X3 (2/3)	2,232	$\frac{1}{2}$
Cumulative cost recognised in previous periods	<u>(1,104)</u>	$\frac{1}{2}$
So necessary adjustment equals	<u>1,128</u>	$1\frac{1}{2}$
		\Rightarrow W4

			Marks	
7	Provision adjustments			
		\$'000		
	Provision required at 31 March 20X2 ($14,250 \times 0.48$)	6,840	½	
	Unwinding of discount ($6,840 \times 8\%$)	547	1	
	So provision required at 31 March 20X3	<u>7,387</u>		
	Amount included in PPE on 31 March 20X2	6,840	½	
	Depreciation to 31 March 20X3 ($1/9.5$)	(720)	½	
	So added to PPE at 31 March 20X3	<u>6,120</u>		
	Amount chargeable to profit or loss ($547 + 720$)	1,267	½	
	Amount charged in financial statements	<u>(1,500)</u>	½	
	So necessary adjustment equals	<u>(233)</u>	3½	
			⇒ W4	
8	Loan adjustment			
		\$'000		
	Initial carrying amount ($20,000 - 1,000$)	19,000	½	
	Finance cost (10%)	1,900	½	
		<u>20,900</u>		
	Included in draft financial statements	<u>(20,000)</u>	½	
	So adjustment equals	<u>900</u>	1½	
			⇒ W4	
9	Investment in Gamma – equity accounting			
		\$'000		
	Cost	74,000	½	
	Share of post-acquisition change in net assets:			
	Retained earnings (W4)	4,000	½	
	Other components of equity (W5)	320	½	
	Unrealised profit (W4)	<u>(1,200)</u>	½	
		<u>77,120</u>	2	
10	Deferred tax on fair value adjustments:			
	Fair value adjustments:			
		1 April 20X2	31 March 20X3	
		\$'000	\$'000	
	Property adjustment	20,000	19,250	½
	Plant and equipment adjustment	9,000	6,000	½
	Intangible asset adjustment	8,000	6,000	½
	Net taxable temporary differences	<u>37,000</u>	<u>31,250</u>	
	Related deferred tax (20%)	<u>7,400</u>	<u>6,250</u>	½
				2
				⇒ W1

55 Alpha Group (12/13)

Top tips. The group accounting question is always a tough one, covering a number of different topics, and with a lot of adjustments to keep track of. This can be off-putting when you first read the question, so make sure you have a plan to get started. The first thing to do is to set up your proforma. Then work through the adjustments in the order they appear in the question. Reference your calculations and show your workings clearly. This is for your benefit as well as for the marker. You will probably find that if you take each issue individually, you know how to deal with each one:

- Acquisition of a subsidiary with a consideration including shares
- Fair value adjustments on subsidiary
- Joint operation
- Revalued land
- Development costs
- Intercompany trading
- Forward currency contract
- Long-term borrowings

Easy marks. As with most groups questions, there are easy marks for slotting the simpler figures into the statement of financial position, or for some simple addition.

Examining team's comments. The principles of calculating goodwill (including the calculation of consideration), investment in associate and group retained earnings were answered well on the whole. Most candidates seemed to know that only intra-group balances for receivables and payables, rather than balances with associates, were adjusted on the consolidated statement of financial position. However there were a number of common mistakes made as listed below.

- The derivative financial asset was often not included in the consolidated statement of financial position although many wrote notes about how it should be dealt with.
- In the deferred tax computation candidates correctly calculated the subsidiary amount on acquisition and the balance at the year-end but then took the incorrect figure to the consolidated statement of financial position.
- Most candidates did not correctly adjust for the 'own goodwill' in the net asset working.
- Many did not understand that the revaluation of non-current assets in the subsidiary needed to be removed. Those that did were not normally able to correctly compute the impact on pre- and post-acquisition reserves.
- For the intangible assets most wrote long explanations demonstrating an understanding of the principles of IAS 38. However, the application was poor. Many confused the correct amount of intangible assets to be capitalised with the research element to be adjusted in the consolidated statement of financial position and so deducted \$20,000 instead of \$35,000.
- Deferred consideration was correctly calculated for the goodwill consideration but many forgot the other side of the double entry and did not unwind and add the interest. Those who did often simply added one year's interest and did not identify the 15 month period.
- The convertible loan workings were often hard to follow. There were a number of mistakes – largely from not understanding how the liability element was calculated. These ranged from applying discount factors to \$60m nominal value instead of the redemption value of \$75.6m to adding up all the interest payments at 8% (despite the question stating that there are none) and discounting these to present value. Then many deducted this from the repayment value instead of \$60m to arrive at the equity figure. The final error seemed to be on calculation of the interest payment where most applied 8% and not 10%.
- For the investment in Gamma many did not deduct the \$2m fair value adjustment (some added it) although it should not have been valued to fair value in the consolidated statement of financial position.
- Many wasted time calculating goodwill for Gamma and then either did not use the figure (the majority) or added it to the associate value.

Marking scheme

Marks

CONSOLIDATED STATEMENT OF FINANCIAL POSITION OF ALPHA AT 30 SEPTEMBER 20X3

ASSETS	\$'000	
Non-current assets:		
Property, plant and equipment (W6)	553,000	1½ (W6)
Intangible assets (W7)	29,000	2 (W7)
Goodwill (W2)	117,966	7½ (W2)
Investment in Gamma (W11)	82,400	1½ (W11)
	<u>782,366</u>	
Current assets:		
Inventories (88,000 + 61,000 – 3,500 (W4))	145,500	½ + ½
Trade receivables (65,000 + 49,000 – 8,000 (intra-group) – nil (associate))	106,000	½ + ½
Financial asset (derivative)	1,100	1
Cash and cash equivalents (12,000 + 10,000)	22,000	½
	<u>274,600</u>	
Total assets	<u>1,056,966</u>	
EQUITY AND LIABILITIES		
Equity attributable to equity holders of the parent		
Share capital	195,000	½
Retained earnings (W4)	147,232	11½ (W4)
Other components of equity (W5)	194,324	3½ (W5)
	<u>536,556</u>	
Non-controlling interest (W3)	53,200	1 (W3)
Total equity	<u>589,756</u>	
Non-current liabilities:		
Deferred consideration (W8)	42,356	1½ (W8)
Long-term borrowings (170,000 + 54,000 – 60,000 + 62,454 (W9))	226,454	½ + ½ + ½ + 1½ (W9)
	<u>86,400</u>	½ + 1 + ½
Deferred tax (50,000 + 35,000 – 1,500 (Note 3) + 2,900 (W12))	<u>86,400</u>	
Total non-current liabilities	<u>355,210</u>	
Current liabilities:		
Trade and other payables (48,000 + 45,000 – 8,000 (intra-group) – nil (associate))	85,000	½
Short-term borrowings (22,000 + 5,000)	27,000	½
Total current liabilities	<u>112,000</u>	<u>40</u>
Total equity and liabilities	<u>1,056,966</u>	

Workings – Do not double count marks. All numbers in \$'000 unless otherwise stated.

Note. Alpha owns 80% of the shares in Beta and 40% of the shares in Gamma.

1 Net assets table – Beta

	1 July 20X2 \$'000	30 September 20X3 \$'000	For W2	For W5
Share capital	150,000	150,000	½	
Other components of equity	5,000	11,000	½	½
Reverse post-acquisition revaluation		(6,000)		½
Retained earnings:				
Per accounts of Beta	98,000	115,000	½	½
Adjustment for own goodwill	(60,000)	(60,000)	½	½
Plant and equipment adjustment	10,000	8,000	½	½
Extra depreciation (8,000 × 15/48)		(2,500)		½
Intangible asset adjustment	12,000	12,000	½	

			Marks
Extra amortisation ($12,000 \times 15/60$)	(3,000)	$\frac{1}{2}$	
Deferred tax on fair value adjustments	(4,400) (2,900)	$1\frac{1}{2}$ (W12)	$1\frac{1}{2}$ (W12)
Net assets for the consolidation	<u>210,600</u> <u>221,600</u>		
The post-acquisition increase in net assets is 11,000 ($221,600 - 210,600$). All of this increase relates to retained earnings			
		<u>$4\frac{1}{2}$</u>	<u>$5\frac{1}{2}$</u>
	\Rightarrow W2		\Rightarrow W2
2 <i>Goodwill on consolidation (Beta)</i>			
	\$'000	\$'000	
Consideration transferred:			
Share exchange ($120 \text{ million} \times 5/6 \times \2.40)	240,000		1
Deferred consideration ($50 \text{ million}/1.10^3$)	<u>37,566</u>		1
		277,566	
Fair value of non-controlling interest at date of acquisition ($30 \text{ million} \times \1.70)		<u>51,000</u>	1
		328,566	
Net assets at 1 April 20X2 (W1)		<u>(210,600)</u>	$4\frac{1}{2}$ (W1)
Goodwill		<u>117,966</u>	<u>$7\frac{1}{2}$</u>
3 <i>Non-controlling interest in Beta</i>			
	\$'000		
Fair value at date of acquisition (W2)	51,000		$\frac{1}{2}$
20% of post-acquisition increase in net assets ($11,000$ (W1))	<u>2,200</u>		$\frac{1}{2}$
	<u>53,200</u>		<u>1</u>
4 <i>Retained earnings</i>			
	\$'000		
Alpha	185,000		$\frac{1}{2}$
Finance costs on deferred consideration (939 (W8) + $3,851$ (W8))	(4,790)		$\frac{1}{2} + \frac{1}{2}$
Adjustment for intangible asset (W7)	(35,000)		$\frac{1}{2}$
Adjustment for finance cost of loan (W9)	(5,678)		$\frac{1}{2}$
Beta ($80\% \times 11,000$ (W1))	8,800		$\frac{1}{2} + 5\frac{1}{2}$ (W1)
Gamma ($40\% \times (75,000 - 66,000)$)	3,600		$\frac{1}{2} + \frac{1}{2}$
Unrealised profits on sales to Beta ($14,000 \times 1/4$)	(3,500)		1
Unrealised profits on sales to Gamma ($12,000 \times 1/4 \times 40\%$)	<u>(1,200)</u>		<u>1</u>
	<u>147,232</u>		<u>$11\frac{1}{2}$</u>
5 <i>Other components of equity – Alpha</i>			
	\$'000		
Alpha	192,000		$\frac{1}{2}$
Deduct gain on revaluation of investment in Gamma	(2,000)		1
Gain on fair value of hedge accounted derivative	1,100		$\frac{1}{2}$
Equity component of convertible loan (W10)	<u>3,224</u>		<u>$1\frac{1}{2}$</u> (W10)
	<u>194,324</u>		<u>$3\frac{1}{2}$</u>
6 <i>Property, plant and equipment</i>			
	\$'000		
Alpha + Beta	555,000		$\frac{1}{2}$
Reversal of post-acquisition revaluation – Beta	(7,500)		$\frac{1}{2}$
Fair value adjustment – Beta ($8,000 - 2,500 - W1$)	<u>5,500</u>		<u>$\frac{1}{2}$</u>
	<u>553,000</u>		<u>$1\frac{1}{2}$</u>

Marks

7	Intangible assets		
		\$'000	
	Alpha (per own financial statements)	55,000	½
	November – May expenditure inappropriately capitalised	(35,000)	1
	Beta at fair value (12,000 – 3,000 – W1)	9,000	½
		<u>29,000</u>	<u>2</u>
8	Deferred consideration		
		\$'000	
	At 1 July 20X2 (W1)	37,566	½
	Finance cost to 30 September 20X2 (10% × 3/12)	939	½
	At 1 October 20X2	<u>38,505</u>	
	Finance cost to 30 September 20X3 (10%)	3,851	½
	At 30 September 20X3	<u>42,356</u>	<u>1½</u>
9	Convertible loan		
		\$'000	
	Initial carrying amount (75,600 × 0.751)	56,776	1
	Finance cost to 30 September 20X3 (10% × 56,776)	5,678	½
	At 30 September 20X3	<u>62,454</u>	<u>1½</u>
10	Equity component of convertible loan		
		\$'000	
	Carrying amount is balancing figure (60,000 – 56,776 (W9))	<u>3,224</u>	<u>1</u>
			⇒ W5
11	Investment in Gamma		
		\$'000	
	Cost	80,000	½
	Share of post-acquisition profits (W4)	3,600	½
	Unrealised profit (W4)	<u>(1,200)</u>	½
		<u>82,400</u>	<u>1½</u>
12	Deferred tax on fair value adjustments		
	Fair value adjustments:		
		1 July	30 September
		20X2	20X3
		\$'000	\$'000
	Plant and equipment adjustment	10,000	5,500
	Intangible asset adjustment	12,000	9,000
	Net taxable temporary differences	<u>22,000</u>	<u>14,500</u>
	Related deferred tax (20%)	<u>4,400</u>	<u>2,900</u>
			<u>1</u>
			<u>3</u>
			⇒ W1

56 Epsilon (12/14)

Top tips. This question focused on group accounts. There was a written part, followed by a computational part.

Part (a) should have been quite easy, provided that you were familiar with IFRS 3 and IFRS 10.

You may have found part (b) more complicated, but as with larger group accounts questions, the key is to break the calculation down into steps: fair value of shares; deferred consideration; contingent consideration; fair values of identifiable net assets; non controlling interest. Read the question carefully, it was asking for the calculation under **both** the partial (proportionate) method of measuring non-controlling interests and the full fair value method.

Easy marks. Part (a) included four easy marks for explaining the IFRS 10 definition of control.

Examining team's comments. Answers to part (a)(i) were of a variable standard. Only a minority of candidates were aware of the way in which control is defined and interpreted in IFRS 10. IFRS 10 has become examinable only relatively recently but candidates need to ensure they are aware of all standards as soon as they become examinable. Answers to parts (a)(ii) and part (b) were generally of a satisfactory standard. Having said this, a number of candidates struggled to correctly measure the three-part cost of Epsilon's investment in Kappa:

- The share exchange should be measured at the market value of the shares issued by Epsilon.
- The deferred cash consideration should be measured at the present value of the future payment.
- The contingent consideration should be measured at its fair value at the acquisition date.

[References: IFRS 3: paras. 32–36; IFRS 10: paras. 6–18]

Marking scheme

		Marks
(a)	(i)	
	IFRS 10 defines control as exposure, or rights to variable returns from the acquired business and the ability to affect those returns through its power over the acquired business.	$\frac{1}{2} + \frac{1}{2} + \frac{1}{2}$
	To have power, the acquirer must have existing rights which give it the current ability to direct the ' relevant activities ' of the acquired business.	$\frac{1}{2} + \frac{1}{2}$
	The ' relevant activities ' of a business are activities which significantly affect the returns of the business. Where two or more investors have the ability to direct relevant activities, control is exercised by the investor who directs the activities which most significantly affect the returns to the acquired business.	$\frac{\frac{1}{2} + \frac{1}{2} + \frac{1}{2}}{4}$
	Note. Exact wordings not required for marks.	
	(ii)	
	Goodwill on acquisition is measured as the excess of the sum of the fair value of the consideration transferred in exchange for control of the acquired business, plus the initial carrying amount of any non-controlling interest in the acquired business less the fair values of the net assets of the acquired business on the acquisition date.	$\frac{1}{2} + \frac{1}{2} + \frac{1}{2} + \frac{1}{2}$
	Goodwill is not amortised but must be tested annually for impairment in accordance with IAS 36 <i>Impairment of Assets</i> . Unimpaired goodwill is shown under non-current assets .	$\frac{1}{2} + \frac{1}{2} + \frac{1}{2}$
	In the case of a bargain purchase (where 'goodwill is negative'), the acquirer should, after ensuring that it has been appropriately measured , recognise an immediate gain in profit or loss at the acquisition date.	$\frac{\frac{1}{2} + \frac{1}{2}}{5}$



			Marks
(b) Computation of goodwill impairment			
	<i>NCI at fair value \$'000</i>	<i>NCI at % of net assets \$'000</i>	$\frac{1}{2} + \frac{1}{2}$
Cost of investment			
Share exchange (12 million \times 75% \times 2/3 \times \$6.50)	39,000	39,000	$\frac{1}{2} + \frac{1}{2} + \frac{1}{2}$
Deferred consideration (7.15 million/1.10)	6,500	6,500	1
Contingent consideration	25,000	25,000	1
Non-controlling interest at date of acquisition:			
Fair value – 3 million \times \$6.00	18,000		1
% of net assets – 68,000 (Working) \times 25%		17,000	1
Net assets at date of acquisition (Working)	(68,000)	(68,000)	2 (Working)
Goodwill on acquisition	20,500	19,500	
Impairment – 10%	2,050	1,950	$\frac{1}{2} + \frac{1}{2}$
Where the NCI is measured at fair value, the impairment should be attributed partly to retained earnings (\$153,750) and partly to NCI (\$51,250). The allocation is normally based on the group structure (75/25 in this case).			1
Where the NCI is measured at % of net assets, the impairment should be attributed wholly to retained earnings.			$\frac{1}{2}$
			<u>11</u>
			<u>20</u>
<i>Working: Net assets at date of acquisition</i>			
		\$'000	
Fair value at acquisition date		70,000	$\frac{1}{2}$
Deferred tax on fair value adjustments (20% (70,000 – 60,000))		(2,000)	$\frac{1}{2} + \frac{1}{2} + \frac{1}{2}$
		<u>68,000</u>	<u>2</u>

57 Alpha (6/15)

Top tips. The group accounting question always looks difficult at first sight. You will need to adopt a methodical approach.

As usual in these types of question you will probably find that if you take each issue individually, you know how to deal with each one. In this question, the issues are:

- Deferred tax
- Financial instruments
- Inter-company trading
- Fair value adjustments
- Restructuring

Easy marks. As with most groups questions, there are easy marks for slotting the simpler figures into the statement of financial position, or for some simple addition.

Examining team's comments. On the whole, this question was answered satisfactorily. Candidates know that question 1 will always be a consolidation question and so understandably study the topic thoroughly. More particularly, most candidates performed well in the following areas:

- Calculating goodwill, especially the calculations of fair value adjustments and the deferred tax on them
- Dealing with the intra-group balances (although a number of candidates adjusted the payables instead of the cash figure for the group cash in transit)

- Calculating the split of debt and equity for the convertible debt (although a number of candidates tried to compute an adjusted finance cost when the debt was issued on the last day of the accounting period)
- Understanding the method for calculating the non-controlling interests even if the numbers were often incorrect
- Dealing with the provision for unrealised profit and calculating the related deferred tax

Areas that were not done as well in some cases were as follows:

- Some candidates, having correctly computed the net assets at the date of acquisition for the purposes of computing goodwill, did not then separate the retained earnings and other components of equity of the subsidiaries into their pre and post-acquisition components for the purposes of computing consolidated reserves.
- Some candidates pro-rated the statement of financial position figure for Gamma to 9/12 (since Gamma was acquired nine months before the year-end).
- A minority of candidates proportionally consolidated the subsidiaries. This has arisen in a number of past examinations. Candidates and tutors should take note of this issue.
- In the retained earnings workings many deducted the provision amounts (that had already been provided for in the draft financial statements) rather than adding back those amounts that were provided incorrectly.
- Whilst most candidates correctly identified the assets as held for sale many did not correctly measure them, on an asset by asset basis, at the lower of current carrying value and fair value less costs to sell.
- Many candidates did not include the premium on the shares issued to acquire Gamma in consolidated 'other components of equity'.

Marking scheme

Marks

CONSOLIDATED STATEMENT OF FINANCIAL POSITION OF ALPHA AT 31 MARCH 20X5

	\$'000	
Assets		
Non-current assets:		
Property, plant and equipment (300,000 + 240,000 + 180,000 + 27,500 (W1) – (12,000 + 3,000 {held for sale assets – W5})	732,500	½ + ½ + ½
Goodwill (W3)	78,600	9½ (W3)
Other investments (33,000 + 43,000 + 11,600)	87,600	1
	<u>898,700</u>	
Current assets:		
Inventories (90,000 + 60,000 + 45,000 – 5,000 (W6))	190,000	½ + ½
Trade receivables (72,000 + 46,000 + 40,000 – (9,000 + 6,000 {intra-group}))	143,000	½ + ½
Cash and cash equivalents (15,000 + 10,000 + 8,000 + (9,000 + 6,000 {transit}))	48,000	½ + ½
	<u>381,000</u>	
Non-current assets classified as held for sale (W5)	<u>13,000</u>	½
Total assets	<u>1,292,700</u>	
Equity and liabilities		
Equity attributable to equity holders of the parent		
Share capital (200,000 + 60,000 (shares issued to acquire Gamma))	260,000	1
Retained earnings (W6)	388,955	12 (W5)
Other components of equity (W8)	<u>132,548</u>	5 (W8)

		Marks
	781,503	
Non-controlling interest (W4)	107,245	2 (W4)
Total equity	<u>888,748</u>	
Non-current liabilities:		
Provision	8,000	½
Long-term borrowings (60,000 + 45,000 + 50,000 + 25,452 (W7) – 30,000)	150,452	½ + ½ + ½
Deferred tax (W10)	86,500	1½
Total non-current liabilities	<u>244,952</u>	
Current liabilities:		
Trade and other payables (45,000 + 42,000 + 33,000)	120,000	½
Short-term borrowings (22,000 + 10,000 + 7,000)	39,000	½
Total current liabilities	<u>159,000</u>	<u>40</u>
Total equity and liabilities	<u>1,292,700</u>	

Workings – Do not double count marks.

All numbers in \$'000 unless otherwise stated

1 Net assets table – Beta

	1 April 20X0 \$'000	31 March 20X5 \$'000	For W3	For W6
Share capital	150,000	150,000	½	
Retained earnings:				
Per accounts of Beta	75,000	115,000	½	½
Property adjustment	30,000	30,000	½	
Extra depreciation (90,000 – 80,000) × 5/20		(2,500)		1
Plant and equipment adjustment	13,000	–	½	½
Other components of equity	1,000	7,000 *	½	½
Deferred tax on fair value adjustments	(8,600)	(5,500)	1 (W9)	1 (W9)
Net assets for the consolidation	<u>260,400</u>	<u>294,000</u>		

The post-acquisition increase in net assets is 33,600 (294,000 – 260,400). 6,000 of this increase

relates to other components of equity and the balance (27,600) relates to retained earnings.

3½
 ⇒W3

4
 ⇒W6

* The other components of equity balance of Beta at 31 March 20X5 is 4,000 + [43,000 – 40,000] (the current year revaluation of Beta's investments).

2 Net assets table – Gamma

	1 July 20X4 \$'000	31 March 20X5 \$'000	For W3	For W6
Share capital	120,000	120,000	½	
Retained earnings:	46,500 ^{*1}	51,000	1	½
Other components of equity	2,000	3,600	½	1
Net assets for the consolidation	<u>168,500</u>	<u>174,600</u>		

The post-acquisition increase in net assets is 6,100 (174,600 – 168,500). 1,600 of this increase relates to other components of equity and the balance (4,500) relates to retained earnings.

2
 ⇒W3

2
 ⇒W6

^{*1} The retained earnings of Gamma at 1 July 20X4 were 45,000 + 3/12 (51,000 – 45,000).

^{*2} The other components of equity balance of Gamma at 31 March 20X5 is 2,000 + [11,600 – 10,000] (the current year revaluation of Gamma's investments).

Marks

3 Goodwill on consolidation

	Beta \$'000	Gamma \$'000	
Costs of investment:			
Cash paid to acquire Beta (not including acquisition costs)	234,500		1
Shares issued to acquire Gamma $60,000 \times \$2.90$		174,000	1
Fair value of non-controlling interest at date of acquisition (30 million \times \$1.80 – Beta; 30 million \times \$1.50 – Gamma)	54,000	45,000	1 + 1
Net assets at date of acquisition (W1/W2)	(260,400)	(168,500)	$3\frac{1}{2}$ (W1) + 2 (W2)
Goodwill	<u>28,100</u>	<u>50,500</u>	<u>9\frac{1}{2}</u>

The total goodwill is 78,600 (28,100 + 50,500).

4 Non-controlling interest

	Beta \$'000	Gamma \$'000	
Fair value at date of acquisition (W3)	54,000	45,000	$\frac{1}{2} + \frac{1}{2}$
20%/25% of post-acquisition increase in net assets (33,600 (W1)/6,100 (W2))	<u>6,720</u>	<u>1,525</u>	$\frac{1}{2} + \frac{1}{2}$
	<u>60,720</u>	<u>46,525</u>	<u>2</u>

The total NCI is 107,245 (60,720 + 46,525).

5 Adjustment for assets held for sale

Asset	Existing carrying amount (E) \$'000	Lower of E and fair value less costs to sell \$'000	Adjustment \$'000	
Property	12,000	12,000	Nil	$\frac{1}{2}$
Plant	<u>3,000</u>	<u>1,000</u>	<u>2,000</u>	$\frac{1}{2}$
	<u>15,000</u>	<u>13,000</u>	<u>2,000</u>	<u>1</u>

⇒W6

6 Retained earnings

	\$'000	
Alpha	367,500	$\frac{1}{2}$
Adjustment for acquisition costs of Beta	(2,500)	$\frac{1}{2}$
Adjustment for disallowable provision (2,500 + 2,000)	4,500	$\frac{1}{2} + \frac{1}{2}$
Adjustment for held for sale asset (W5)	(2,000)	1 (W5)
Beta (80% \times 27,600 (W1))	22,080	$\frac{1}{2} + 4$ (W1)
Gamma (75% \times 4,500 (W2))	3,375	$\frac{1}{2} + 2$ (W2)
Unrealised profits on sales to Beta and Gamma (20% \times (15,000 + 10,000))	(5,000)	1
Deferred tax on unrealised profits (20% \times 5,000)	<u>1,000</u>	<u>1</u>
	<u>388,955</u>	<u>12</u>

7 Convertible loan

	\$'000	
Present value of interest payments (1,800 \times 3.790)	6,822	$\frac{1}{2}$
Present value of principal repayment (30,000 \times 0.621)	<u>18,630</u>	$\frac{1}{2}$
So loan element equals	<u>25,452</u>	
Equity component is the balancing figure	<u>4,548</u>	$\frac{1}{2}$
	<u>30,000</u>	<u>1\frac{1}{2}</u>

⇒W8

Marks

8	Other components of equity			
		\$'000		
	Alpha	5,000		½
	Premium on issue of shares to acquire Gamma (60 million × \$1.90)	114,000		1
	Revaluation of 'other investments' of Alpha (33,000 – (267,000 – 237,000))	3,000		1
	Equity element of convertible loan (W7)	4,548	1½ (W7)	
	Beta (80% × 6,000 (W1))	4,800		½
	Gamma (75% × 1,600 (W2))	1,200		½
		<u>132,548</u>		<u>5</u>
9	Deferred tax on fair value adjustments – Beta			
	Fair value adjustments:			
		1 April 20X4	31 March 20X5	
		\$'000	\$'000	
	Property adjustment	30,000	27,500	½
	Plant and equipment adjustment	13,000	Nil	½
	Net taxable temporary differences	<u>43,000</u>	<u>27,500</u>	½
	Related deferred tax (20%)	<u>8,600</u>	<u>5,500</u>	½
				<u>2</u>
				⇒W1
10	Deferred tax			
		\$'000		
	Alpha + Beta + Gamma	82,000		½
	On fair value adjustments in Beta (W9)	5,500		½
	On unrealised profits (W6)	<u>(1,000)</u>		½
		<u>86,500</u>		<u>1½</u>

58 Ayre (12/15)

Top tips. This is a typical group accounting question and at first sight it may look difficult. As usual, you should work methodically, taking each issue in turn. Always provide full and clear workings and reference each working to your main answer. The more simple workings can be done on the face of the statement of financial position. If you have practised similar questions, you should be able to make a good attempt at this one. In this question, the main issues are:

- Financial instruments
- Decommissioning liability
- Impairment of goodwill

Remember to leave enough time to complete part (b), which required you to discuss the application of IFRS 10.

Easy marks. As usual, there are easy marks for slotting the simpler figures into the statement, or for some simple addition.

Examining team's comments. On the whole, this question was answered satisfactorily. Candidates know that question 1 will always be a consolidation question and so understandably study the topic thoroughly.



More particularly, most candidates performed well in the following areas:

- The initial calculation of goodwill, especially the calculations of fair value adjustments and the deferred tax on them
- The computation of unrealised profits on intra-group sales (although many did not appreciate the implications of the sale being originated by a subsidiary, rather than the parent)
- The correct identification of the need to discount the de-commissioning liability to present value (although many did not appreciate that the corresponding debit entry was to property, plant and equipment rather than to profit or loss)
- The correct calculation of the finance cost associated with the zero-coupon bond and the appropriate closing liability

Areas that were not done as well in some cases were as follows:

- Very few candidates were aware of the need to gross up goodwill when performing an impairment review when the non-controlling interest in the relevant subsidiary is measured using the proportion of net assets method.
- Many candidates seemed unsure of the treatment of acquisition costs when computing goodwill on the consolidation of subsidiaries.
- A minority of candidates attempted to make adjustments to eliminate intra-group balances despite the question clearly stating that this was not necessary.
- A minority of candidates proportionally consolidated the subsidiaries. This has arisen in a number of past examinations. Candidates and tutors should take note of this issue.

Part (b) of this question – for 4 marks – required candidates to reflect on the appropriate accounting treatment of a share purchase by Ayre in the year ended 30 September 20X6. This part was not generally well answered and a significant number of candidates omitted it altogether. Those that did attempt it often referred to the purchase as a 'non-adjusting event after the reporting date'. Such candidates did not read the dates in the question carefully enough. Only a minority of candidates seemed aware of the provisions of IFRS 10 regarding identification of subsidiary status. A number of candidates incorrectly stated that it was always necessary to own more than 50% of the shares in an entity before that entity can be regarded as a subsidiary.

[References: IFRS 10: paras. 6–18, B47–B50]

Marking scheme

Marks

(a) CONSOLIDATED STATEMENT OF FINANCIAL POSITION OF AYRE AT 30 SEPTEMBER 20X5

	\$'000	
Assets		
Non-current assets		
Property, plant and equipment (380,000 + 355,000 + 152,000 + 18,000 (W1) + 30,000 (W2) + 10,000 (provision))	945,000	½ + ½ + ½ + ½
Intangible assets (80,000 + 40,000 + 20,000 + 10,000 (W1))	150,000	½ + ½
Goodwill (W3)	39,500	11 (W3)
Other investments (W8)	10,800	2 (W8)
	<u>1,145,300</u>	
Current assets		
Inventories (100,000 + 70,000 + 65,000 – 7,200 (unrealised profit))	227,800	½ + ½
Trade receivables (80,000 + 66,000 + 50,000)	196,000	½
Cash and cash equivalents (10,000 + 15,000 + 10,000)	35,000	½
	<u>458,800</u>	
Total assets	<u>1,604,100</u>	

Marks

Equity and liabilities

Equity attributable to equity holders of the parent

Share capital	150,000	½
Retained earnings (W6)	515,180	11 (W6)
Other components of equity (W7)	295,000	1 (W7)

960,180

Non-controlling interest (W4)

185,200

1½ (W5)

*Total equity*1,145,380*Non-current liabilities:*

Provision	10,000	½
Long-term borrowings (60,000 + 50,000 + 45,000 + 2,120 (W6))	157,120	½ + ½
Deferred tax (W9)	101,600	1½ (W9)

268,720*Total non-current liabilities**Current liabilities:*

Trade and other payables (50,000 + 55,000 + 35,000)	140,000	½
Short-term borrowings (25,000 + 15,000 + 10,000)	50,000	½

190,00036*Total current liabilities**Total equity and liabilities*1,604,100*Workings – Do not double count marks. All numbers in \$'000 unless otherwise stated.*1 *Net assets table – Bee*

	1 October 20X2 \$'000	30 September 20X5 \$'000	For W3	For W6
Share capital	200,000	200,000	½	
Retained earnings:				
Per accounts of Bee	125,000	186,000	½	½
Plant fair value adjustment	45,000	45,000	½	
Extra depreciation due to fair value adjustment (45,000 × 3/5)		(27,000)		½
Research project fair value adjustment	20,000	20,000	½	
Extra amortisation due to FV adjustment (20,000 × 2/4)		(10,000)		½ + ½
Unrealised profit on intra-group sales (1/5 × 36,000)		(7,200)		½ + ½
Other components of equity	10,000	10,000	½	
Deferred tax on fair value adjustments (20%)	(13,000)	(5,600)	½	½
Net assets for the consolidation	<u>387,000</u>	<u>411,200</u>		

The post-acquisition increase in net assets is 24,200 (411,200 – 387,000).

	½
<u>3</u>	<u>4½</u>
⇒W3	⇒W6



2 *Net assets table – Cee*

	1 October 20X4 \$'000	30 September 20X5 \$'000	For W3	For W6
Share capital	120,000	120,000	½	
Retained earnings:	45,000	60,000	½	½
Land adjustment	30,000	30,000	½	½
Other components of equity	2,000	2,000	½	
Deferred tax on FV adjustment (20% × 30,000)	(6,000)	(6,000)	½	½
Net assets for the consolidation	191,000	206,000		
+ post-acquisition increase in net assets is 15,000 (206,000 – 191,000).				½
			2½	2
			⇒W3	⇒W6

3 *Goodwill on consolidation*

	Bee \$'000	Cee \$'000	
Costs of investment:			
Shares issued to acquire Bee (150,000 × \$2.40)	360,000		1
Cash paid to acquire shares in Cee	125,000		½
Non-controlling interests at date of acquisition:			
Bee – 25% × 387,000 (W1)	96,750		½ + ½
Cee – 40% × 191,000 (W2)		76,400	
Net assets at date of acquisition (W1/W2)	(387,000)	(191,000)	3 (W1) + 2½ (W2)
Goodwill before impairment	69,750	10,400	
Impairment of Bee goodwill (W4)	(40,650)	Nil	3 (W4)
	29,100	10,400	11

The total goodwill is 39,500 (29,100 + 10,400).

4 *Impairment of Bee goodwill*

	\$'000	
Net assets of Bee as per the consolidated financial statements (W1)	411,200	½
Grossed up goodwill on acquisition (100/75 × 69,750)	93,000	1
	504,200	
Recoverable amount of Bee as a CGU	(450,000)	½
So gross impairment equals	54,200	½
75% thereof equals	40,650	½
		3 W3

5 *Non-controlling interest (proportion of net assets method)*

	Bee \$'000	Cee \$'000	
Net assets at 30 September 20X5 (W1/2)	411,200	206,000	½
Non-controlling interest (25%/40%)	102,800	82,400	½ + ½
			1½

The total NCI is 185,200 (102,800 + 82,400).



		Marks
6	<i>Retained earnings</i>	
	\$'000	
Ayre	498,000	½
Adjustment for acquisition costs of Bee	(1,200)	½
Adjustment for decommissioning provision	34,000	½
Adjustment for finance cost on zero-coupon bond (8% × (40,000 – 1,000) – 1,000)	(2,120)	1 + ½
Bee (75% × 24,200 (W1))	18,150	½ + 4½ (W1)
Cee (60% × (15,000 (W2))	9,000	½ + 2 (W2)
Impairment of Bee goodwill (W4)	(40,650)	½ (W4)
	<u>515,180</u>	<u>11</u>
7	<i>Other components of equity</i>	
	\$'000	
Ayre – per own financial statements	295,000	½
Bee and Cee – post-acquisition only	Nil	½
	<u>295,000</u>	<u>1</u>
8	<i>'Other investments' of Ayre</i>	
	\$'000	
Investments figure per Ayre statement of financial position	497,000	½
Deduct: investments to be eliminated on consolidation		
Shares issued to acquire Bee (W3)	(360,000)	½
Due diligence costs on Bee acquisition	(1,200)	½
Cash paid to acquire Cee (W3)	(125,000)	½
Carrying value of remaining investments	<u>10,800</u>	<u>2</u>
9	<i>Deferred tax</i>	
	\$'000	
Ayre + Bee + Cee	90,000	½
On fair value adjustments in Bee (W1)	5,600	½
On fair value adjustments in Cee (W2)	6,000	½
	<u>101,600</u>	<u>1½</u>
(b)	Advice on appropriate treatment of Theta	
	According to IFRS 10 Consolidated Financial Statements Theta is a subsidiary of Ayre if Ayre controls Theta.	½ + ½
	A key aspect of determining control is considering whether Ayre has power to direct the relevant activities of Theta. Based on its current shareholding, Ayre cannot exercise that power by voting rights as Ayre owns only 45% of the shares.	½ + ½
	However, IFRS 10 states that where potential voting rights (eg share options) are currently exercisable, they should be taken into account in considering whether control exists.	1
	If Ayre exercised its options, this would take its total shareholding in Theta to 55%. On this basis, the directors of Ayre should regard Theta as a subsidiary.	1
		<u>4</u>
		<u>40</u>

59 Alpha Group 8 (2011 Pilot Exam) (amended)

BPP Study Text reference. Chapters 20 and 22.

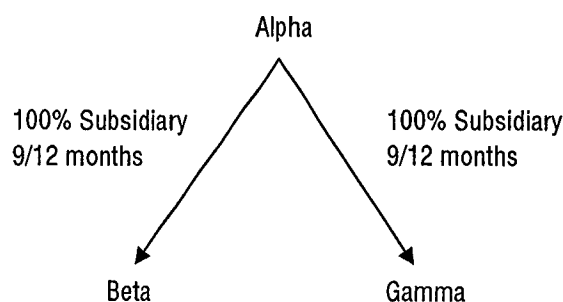
Top tips. This is a tough question, with a large number of adjustments to keep track of. However, it is not quite as intimidating as it may first appear, as you should be able to deal with each of the individual issues. It is therefore crucial that you adopt a logical approach, working logically through the question and following your adjustments through, to make sure that you do not get confused by the sheer size of the question.

Marking scheme

CONSOLIDATED STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME OF ALPHA AT 31 MARCH 20Y1		Marks
Revenue (W2)	432,500	1½
Cost of sales (W3)	(338,752)	13½
Gross profit	93,748	½
Distribution costs $7,000 + (6,000 \times 9/12) + (6,000 \times 9/12)$	(16,000)	½
Administrative expenses (W7)	(21,696)	4½
Investment income (W9)	6,000	2½
Finance cost (W10)	(18,615)	7½
Other income 6,000 (W5) + 6,875 (W16)	12,875	1
Profit before tax	56,312	
Income tax expense $12,800 + (9/12 \times 7,500)$	(18,425)	½
Profit for the year	37,877	
Other comprehensive income (W13)	9,125	1
Total comprehensive income for the year	47,012	½
Profit attributable to:		
Owners of the parent	37,077	
Non-controlling interests	(800)	
	37,877	3½
Total comprehensive income attributable to:		
Owners of the parent	46,512	
Non-controlling interests	(500)	
	47,012	3
		<u>40</u>

Workings – All figures in \$'000 unless indicated otherwise

1 Group structure



2	<i>Revenue</i>		
	Alpha	240,000	
	Beta ($\times 9/12$)	112,500	
	Gamma ($\times 9/12$)	90,000	
	Intra-group sales	<u>(10,000)</u>	
		432,500	
3	<i>Cost of sales</i>		
	Alpha		190,000
	Beta ($\times 9/12$)		82,500
	Gamma ($\times 9/12$)		75,000
	Less intra-group sales		<u>(10,000)</u>
	PUP: Gamma ($20\% \times 2,500$)		500
	Additional depreciation (W4)		1,500
	Reversal of wrongly capitalised development costs		<u>(4,000)</u>
	Amortisation of above ($4,000 \times 1/5 \times 3/12$)		200
	Goodwill impairment (W6)		<u>3,052</u>
			338,752
4	<i>Plant and equipment – depreciation</i>		
	FV	66,000	
	Carrying amount	<u>(60,000)</u>	
	Excess	6,000	
	Depreciation ($\times 1/3 \times 9/12$)	1,500	
5	<i>Goodwill on acquisition of Gamma</i>		
	Consideration transferred:		
	Share exchange ($30,000 \times \$2.00$)	60,000	
	Contingent consideration	15,000	
	FV of NCI at acquisition date	<u>15,000</u>	
			90,000
	Net assets of Gamma at acquisition date:		
	Per financial statements	80,000	
	FV Adjustments:		
	Plant and equipment ($66,000 - 60,000$)	6,000	
	Loan ($34,550 - 32,000$)	<u>(2,550)</u>	
			<u>(83,450)</u>
	Goodwill on acquisition		6,550
The decline in the amount of the contingent consideration (\$6m) relates to the post-acquisition period and should be included within other income.			
6	<i>Goodwill impairment</i>		
	Gamma FV at acquisition date (W5)		83,450
	Post-acquisition profits:		
	Per own records ($300 \times 9/12$)	225	
	Extra depreciation (W4)	<u>(1,500)</u>	
	Reduced finance cost ($(32,000 - 34,550 \times 8\%) \times 9/12$)	327	
			<u>(948)</u>
	Goodwill on acquisition (W5)		<u>6,550</u>
			89,052
	Recoverable amount		<u>(86,000)</u>
	Impairment		3,052

ANSWERS

7	<i>Admin expenses</i>			
	Alpha			10,000
	Beta ($\times 9/12$)			5,250
	Gamma ($\times 9/12$)			6,000
	Legal & professional fees (Note 2)			600
	Provision – remove			(350)
	Depreciation on capitalised restoration costs (W8)			<u>196</u>
				21,696
8	<i>Capitalised restoration costs</i>			
	Provision required ($3,500 \times 0.56$)			<u>1,960</u>
	Depreciation at 10% (W7)			<u>196</u>
9	<i>Investment income</i>			
	Alpha			18,000
	Dividend received from Beta			(10,000)
	Interest received from Beta ($40,000 \times 5\% \times 9/12$)			(1,500)
	Gain on sale of investment incorrectly reclassified (Note 8)			<u>(500)</u>
				6,000
10	<i>Finance cost</i>			
	Alpha			8,000
	Beta ($\times 9/12$)			3,000
	Gamma ($\times 9/12$)			5,400
	Interest paid by Beta to Alpha ($\times 9/12$)			(1,500)
	Fair value adjustment (W6)			(327)
	Finance cost on foreign currency loan ($20,000 \times 10\% \times 1/5$)			400
	Exchange gain on foreign currency loan (W11)			(1,000)
	Unwinding of discount (W12)			118
	Finance cost on convertible loan ($90,480 \times 5\%$)			<u>4,524</u>
				18,615
11	<i>Exchange gain on foreign currency loan</i>			
		Francs ('000)	Rate	\$'000
	Opening balance	20,000	4	5,000
	Finance cost	2,000	5	400
	Exchange gain			<u>(1,000)</u>
	Closing balance	22,000	5	4,400
12	<i>Unwinding of discount</i>			
	Initial provision (W8)	<u>1,960</u>		
	Unwinding of discount (6%)	118		
13	<i>Other comprehensive income</i>			
	Alpha			6,000
	Beta ($\times 9/12$)			1,500
	Gamma ($\times 9/12$)			1,125
	Gain on sale of investment incorrectly reclassified (W9)			<u>500</u>
				9,125
14	<i>Non-controlling interest in profit of Gamma</i>			
	Net adjusted post-acquisition loss of Gamma (W6)			(2,073)
	Impairment of goodwill			<u>(1,927)</u>
				(4,000)
	Non-controlling interest (20%)			(800)



15	<i>Non-controlling interest in total comprehensive income of Gamma</i>	
	Other comprehensive income of Gamma (W6)	1,500
	Non-controlling interest (20%)	300
	Non-controlling interest in profit (W14)	(800)
	Total non-controlling interest	(500)
16	<i>Profit on disposal of Beta</i>	
	Proceeds of sale	65,000
	Net assets at date of disposal $45,000 + (9/12 \times 17,500)$	(58,125)
	Profit on disposal	6,875

60 Alpha, Beta, Gamma (6/11) (amended)

Top tips. This is a tough question, with a large number of adjustments to keep track of. However, it is not quite as intimidating as it may first appear, as you should be able to deal with each of the individual issues. It is therefore crucial that you adopt a logical approach, working logically through the question and following your adjustments through, to make sure that you do not get confused by the sheer size of the question.

Easy marks. As with most groups questions, there are easy marks for slotting the simpler figures into the SPLOCI or SOCE, or for some simple addition. Make sure you get the marks here for Distribution & Administrative expenses, and for Income tax. The SPLOCI has easy marks for dividends and for other comprehensive income.

Marking scheme

Marks

(a)

CONSOLIDATED STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME OF ALPHA AT 31 MARCH 20X8

	Alpha \$'000	
Revenue (W1)	886,000	1½
Cost of sales (balancing figure)	(481,875)	½
Gross profit (W2)	404,125	16
Distribution costs ($18,000 + 17,000$)	(35,000)	½
Administrative expenses ($19,000 + 16,000$)	(35,000)	½
Investment income (W6)	2,800	1
Finance cost (W7)	(139,132)	4
Share of losses of associate (W9)	(7,270)	2
Profit before tax	190,523	
Income tax expense ($41,000 + 33,000$)	(74,000)	½
Profit for the year	116,523	
Other comprehensive income (W10)	5,900	2½
Comprehensive income for the year	122,423	
Profit attributable to:		
Non-controlling interests (W11)	17,464	2½
Owners of the parent	99,059	½
	116,523	

		Marks
Comprehensive income attributable to:		
Non-controlling interests	17,464	½
Owners of the parent	104,959	½
	<u>122,423</u>	<u>33</u>

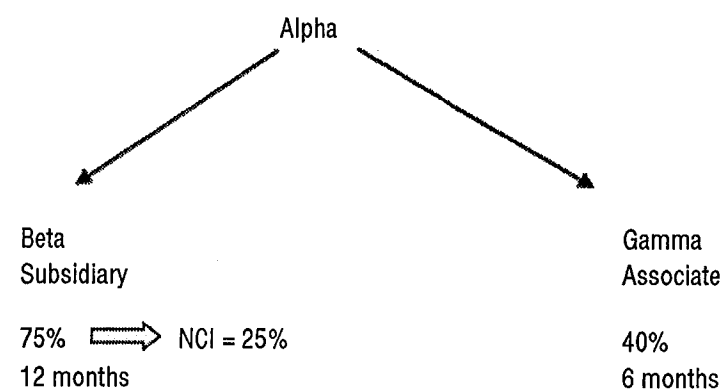
(b)

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY OF ALPHA AT 31 MARCH 20X8

	Equity holders of the parent	Non-controlling interest	Total	
	\$'000	\$'000	\$'000	
Balance at 1 April 20X7 (W12, W13)	602,981	100,994	703,975	4
Comprehensive income for the year	104,959	17,464	122,423	1
Equity component of convertible bonds	35,850	–	35,850	1
Dividends	(52,000)	(10,000)	(62,000)	1
Balance at 31 March 20X8	<u>691,790</u>	<u>108,458</u>	<u>800,248</u>	<u>7</u>
				<u>40</u>

Workings – All amounts \$'000 unless otherwise indicated

Group structure



1	Revenue		
	Alpha	470,000	½
	Beta	434,000	1
	Intercompany sales (from Beta to Alpha)	<u>(18,000)</u>	
		886,000	
2	Gross profit		
	Alpha	214,000	
	Beta	216,000	½
	Environmental provision (3,000 + 2,000)	(5,000)	1½
	PUP: Beta (= 1/4 × (3,600 – 2,100))	(375)	1
	Extra depreciation on FV adjustments (W3)	(11,000)	1½
	FV contingent consideration change *	(6,000)	1
	Goodwill impairment (W5)	<u>(3,500)</u>	9½
		<u>404,125</u>	

* This amount could also be shown elsewhere in the statement of profit or loss, eg as an admin expense.

			Marks
3	<i>Depreciation on adjustments</i>		
	PPE – $1/4 \times (\$280\text{m} - \$240\text{m})$	10,000	1
	Brand amortisation ($1/30 \times \$30\text{m}$)	<u>1,000</u>	$\frac{1}{2}$
		11,000	W2
4	<i>Goodwill in Beta</i>		
	Fair value of consideration transferred:		
	Share exchange ($75,000 \times 2/3 \times \6)	300,000	1
	Contingent consideration – FV at acquisition	<u>55,000</u>	1
	Acquisition costs	<u>–</u>	1
		355,000	
	Non-controlling interest at fair value ($25,000 \times \$3.20$)	<u>80,000</u>	W13 1
		435,000	
	Less fair value of Beta's net assets at 1/10/09		
	Carrying amounts	300,000	$\frac{1}{2}$
	PPE FV adj ($\$280\text{m} - \240m)	<u>40,000</u>	$\frac{1}{2}$
	Brand FV adj	<u>30,000</u>	$\frac{1}{2}$
		(370,000)	$\frac{1}{2}$
	Goodwill	<u>65,000</u>	W5
5	<i>Goodwill impairment</i>		
	Beta carrying amount at 31/03/X8 in own FS	435,000	$\frac{1}{2}$
	FV adjustments:		
	PPE ($\$280\text{m} - \240m) $\times (2.5/4)$	25,000	1
	Brand ($\$30\text{m} \times (28.5/30)$)	<u>28,500</u>	1
	Goodwill (W4)	<u>65,000</u>	
	Carrying amount in group FS	553,500	
	Recoverable amount	<u>(550,000)</u>	$\frac{1}{2}$
	Excess over recoverable amount = impairment	3,500	W2, W11 $\frac{1}{2}$
6	<i>Investment income</i>		
	Alpha	37,300	
	Beta	–	$\frac{1}{2}$
	Dividend from Beta to Alpha	<u>(30,000)</u>	$\frac{1}{2}$
	Profit on disposal – moved to OCI (in line with IFRS 9)	<u>(4,500)</u>	W10
		2,800	
7	<i>Finance costs</i>		
	Alpha	68,000	
	Beta	<u>65,000</u>	$\frac{1}{2}$
	Convertible loan notes incorrectly recorded by Alpha	<u>(15,000)</u>	$\frac{1}{2}$
	Finance cost of convertible loan notes (W8)	<u>21,132</u>	
		139,132	
8	<i>Convertible bonds recorded incorrectly by Alpha</i>		
	PV of principal ($300,000 \times 0.681$)	204,300	1
	PV of interest ($15,000 \times 3.99$)	<u>59,850</u>	1
	Total liability component	264,150	
	Equity element (β)	<u>35,850</u>	(SPLOCI) 1
	Total proceeds of issue	300,000	
	Finance cost ($= 0.08 \times 264,150$)	21,132	W7 1

			Marks
9	<i>Share of associate's losses</i>		
	Gamma loss after tax	(26,000)	½
	Share of Gamma's loss ($40\% \times 26,000 \times 6/12$)	(5,200)	1
	Impairment	(1,800)	1
	PUP: Gamma ($= 1/4 \times 2,700 \times 40\%$)	<u>(270)</u>	1
		(7,270)	
10	<i>Other comprehensive income</i>		
	Revaluation gain on investment in Epsilon	1,400	
	Profit on disposal of investment in Delta (W6)	<u>4,500</u>	
		5,900	
11	<i>NCI share of Beta profits</i>		
	Beta net profit	85,000	½
	PUP (375 + 270 (W2))	(645)	½
	Additional depreciation (W3)	(11,000)	½
	Goodwill impairment (W5)	<u>(3,500)</u>	½
		69,855	
	NCI	17,464	½
12	<i>Opening group equity</i>		
		<i>Alpha</i>	
	Per question	540,000	
	Additional depreciation ($11,000 (W3) \times 0.5$)		
	Pre-acquisition retained earnings		
	PUP on opening inventory ($1/4 \times 2,100$)		
		<i>Beta</i>	
		390,000	½
		(5,500)	½
		(300,000)	½
		(525)	½
		83,975	
	Group share of post-acq'n retained earnings:		
	Beta $\times 75\%$	62,981	½
		602,981	
13	<i>NCI Beta opening equity</i>		
	NCI on acquisition (W4)	80,000	½
	NCI share of group post-acquisition equity ($83,975 (W12) \times 25\%$)	<u>20,994</u>	1
		100,994	

61 Alpha (12/12) (amended)

Top tips. The group accounting question is always a tough one, covering a number of different topics, and with a lot of adjustments to keep track of. This can be off-putting when you first read the question, so make sure you have a plan to get started. The first thing to do is to set up your proforma. Then work through the adjustments in the order they appear in the question. Reference your calculations and show your workings clearly. This is for your benefit as well as for the marker. You will probably find that if you take each issue individually, you know how to deal with each one:

- Acquisition of a subsidiary through share exchange
- Treatment of acquisition costs
- Test of impairment of subsidiary
- Non-controlling interest
- Joint arrangement
- Foreign currency
- Fundamental accounting requirements for consolidation of subsidiaries and associates

Easy marks. As with most groups questions, there are easy marks for slotting the simpler figures into the statement of financial position, or for some simple addition.

Examining team's comments. On the whole this question was answered reasonably well although the standard of the workings varied considerably. It is very important that candidates show clear workings to support the figures that are being produced in a question like this.

Areas showing good knowledge:

- Most candidates correctly consolidated the parent and subsidiary (Beta) with only a small number attempting to proportionally consolidate Beta.
- Most candidates used good standard formats although some did not split the total comprehensive income between the group and the non-controlling interest (NCI). It was also pleasing to see that most made an attempt to calculate the profit relating to the NCI.
- Calculations for goodwill were often correct.
- Most candidates were able to correctly account for the unrealised profits on inter-company trading, although a reasonable number did not adjust for only the group share of the unrealised profit with the joint venture (Gamma).

Areas where mistakes were common:

- Many candidates used proportionate consolidation to deal with Gamma – not the equity method.
- For the deferred tax charge for the year many either ignored the movement going to profit or loss or added the closing balance.
- The share based payment was often incorrect. Many thought this was the second year of the scheme so deducted a charge for last year. In addition it was placed in some strange sections of the statement, eg other comprehensive income (OCI) instead of cost of sales or administrative expenses.
- Some added the adjustments for investment income and finance cost instead of deducting them.
- The impairment for Gamma was often not calculated correctly (ignoring the dividend and taking the wrong proportion for the period). Also because candidates had used the wrong method to account for it they did not know where to put the impairment and often included it in cost of sales.
- Calculations of the gain on investment at FVTOCI and the reclassification of the cash flow hedge were rarely done correctly. The figure most commonly added to OCI for the former was \$100,000 (rather than \$50,000). Few candidates were aware that the gain on re-measurement of the hedging derivative was taken initially to OCI and then reclassified to profit or loss.

Marking scheme

Marks

CONSOLIDATED STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME OF ALPHA
FOR THE YEAR ENDED 30 SEPTEMBER 20X2

	\$'000	
Revenue (W1)	365,000	1½
Cost of sales (balancing figure)	(285,650)	½
Gross profit (W2)	79,350	14½
Distribution costs (7,000 + 6,000)	(13,000)	½
Administrative expenses (W5)	(26,000)	5
Investment income (W6)	200	2½
Finance cost (W7)	(10,850)	2
Other income (re-classified gains on cash flow hedge)	5,000	1
Share of profit of joint venture (W8)	4,600	3
Profit before tax	39,300	
Income tax expense (W10)	(14,550)	2½
Net profit for the period	24,750	
Other comprehensive income (W12)	(950)	2
Total comprehensive income	23,800	
Net profit attributable to:		
Non-controlling interest (W13)	1,600	3½
Controlling interest	23,150	½
	24,750	
Total comprehensive income attributable to:		
Non-controlling interest	1,600	½
Controlling interest	22,200	½
	23,800	40

Workings – Do not double count marks

1 Revenue

	\$'000	
Alpha + Beta	390,000	½
Intra-group sales – to Beta	(25,000)	½ + ½
	365,000	1½

2 Gross profit

	\$'000	
Alpha + Beta	90,000	½
Unrealised profit Beta (20% × \$5m)	(1,000)	1
Extra depreciation (\$4m × ½)	(2,000)	1
Extra amortisation (\$6m × 12/18)	(4,000)	1
Additional cost of sales of inventory	(200)	1
Impairment of goodwill (W3)	(3,450)	9
	79,350	13½

			Marks
3	<i>Impairment of goodwill</i>		
		\$'000	
	Carrying amount of Beta at reporting date:		
	As per own SOCE (\$88m + \$16.1m – \$10m (the dividend))	94,100	1
	Fair value adjustment on PPE (\$4m × ½)	2,000	1
	Fair value adjustment on intangible (\$6m × 6/18)	2,000	1
	Deferred tax on fair value adjustments (\$2.55m (W4) – \$1.55m (W10))	(1,000)	1
	Goodwill on acquisition (W4)	24,350	4½
		<u>121,450</u>	
	Recoverable amount	(118,000)	½
	So impairment equals	<u>3,450</u>	<u>9</u>
4	<i>Goodwill on acquisition of Beta</i>		
		\$'000	\$'000
	Cost of investment:		
	Share exchange (32,000 × \$2.50)	80,000	½
	Contingent consideration	20,000	½
	Fair value of non-controlling interest at date of acquisition	20,000	½
		<u>120,000</u>	
	Equity of Gamma at date of acquisition:		
	Per own records	88,000	½
	Fair value adjustments:		
	Plant and equipment	4,000	½
	Intangible asset	6,000	½
	Inventory	200	½
	Deferred tax on fair value adjustments (25% × (\$4m + \$6m + \$200,000))	(2,550)	1
	For consolidation purposes	<u>(95,650)</u>	
	So goodwill	<u>24,350</u>	<u>4½</u>
			⇒ (W3)
5	<i>Administrative expenses</i>		
		\$'000	
	Alpha + Beta	17,000	½
	Increase in fair value of contingent consideration	2,000	1
	Beta acquisition costs	1,000	1½
	Charge for share based payment award (2,500 × 960 × \$5 × ½)	6,000	2
		<u>26,000</u>	<u>5</u>
Tutorial note. The above costs would, if sensibly included elsewhere in the statement, have also been awarded credit.			
6	<i>Investment income</i>		
		\$'000	
	Per accounts of Alpha	15,300	½
	Dividend received from Beta	(8,000)	½
	Interest received from Beta (40,000 × 5%)	(2,000)	½
	Dividend received from Gamma	(5,000)	½
	Increase in fair value of investment in Zeta	(100)	½
	Residue in consolidated profit or loss	<u>200</u>	<u>2½</u>
7	<i>Finance cost</i>		
		\$'000	
	Alpha + Beta	12,900	½
	Interest paid by Beta to Alpha (W6)	(2,000)	½
	Transaction costs of investment in Zeta	(50)	1
	Residue in profit and loss	<u>10,850</u>	<u>2</u>

			Marks
8	<i>Share of profits of Gamma</i>		
		\$'000	
	Share of profit ($\$20\text{m} \times 50\% \times 9/12$)	7,500	1
	Impairment (W9)	(2,500)	2 (W9)
	Unrealised profit on sales from Alpha ($20\% \times \$4\text{m} \times 50\%$)	(400)	1
		<u>4,600</u>	<u>4</u>
9	<i>Impairment of investment in Gamma</i>		
		\$'000	
	Cost	50,000	1/2
	Share of profit ($\$20\text{m} \times 50\% \times 9/12$)	7,500	1/2
	Dividend received	(5,000)	1/2
	Carrying amount	<u>52,500</u>	
	Recoverable amount	<u>(50,000)</u>	1/2
	So impairment equals	<u>2,500</u>	<u>2</u>
			⇒ W8
10	<i>Income tax expense</i>		
		\$'000	
	Alpha + Beta	16,100	1/2
	Reversal of temporary differences on fair value adjustments (W11)	(1,550)	2
		<u>14,550</u>	<u>2 1/2</u>
11	<i>Reversal of temporary differences</i>		
		\$'000	
	Depreciation	2,000	1/2
	Amortisation	4,000	1/2
	Cost of sales	200	1/2
		<u>6,200</u>	
	25% × \$6.2m equals	<u>1,550</u>	1/2
			<u>2</u>
			⇒ (W10)
12	<i>Other comprehensive income</i>		
		\$'000	
	Gain on cash flow hedge	4,000	1/2
	Reclassification of gain on cash flow hedge	(5,000)	1/2
	Gain on investment at FVTOCI ($100,000 \times \$1 - \$50,000$)	50	1
		<u>(950)</u>	<u>2</u>
13	<i>Non-controlling interest in Beta</i>		
		\$'000	
	Profit after tax	16,100	1/2
	Fair value adjustments (W11)	(6,200)	1/2
	Deferred tax on fair value adjustments (W11)	1,550	1
	Impairment of goodwill (W3)	<u>(3,450)</u>	1
		<u>8,000</u>	
	Non-controlling interest (20%)	<u>1,600</u>	1/2
			<u>3 1/2</u>

62 Alpha Group (6/14) (amended)

Top tips. The group accounting question always looks difficult at first sight. You will need to adopt a methodical approach. Start with part (a), a 5 mark written question.

As usual, in part (b), you will probably find that if you take each issue individually, you know how to deal with each one. In this question, the issues are:

- Impairment of goodwill (Beta)
- Acquisition of Gamma (a subsidiary) during the year
- Inter-group trading between Alpha and Beta
- Defined benefit pension plan
- Investment income
- Revaluation of property
- A hedging transaction (this is much easier than it looks)
- Deferred tax (applies to many of the adjustments)

Easy marks. As with most groups questions, there are easy marks for slotting the simpler figures into the statement of profit or loss and other comprehensive income, or for some simple addition. The figures for distribution costs and investment income are among the easier figures.

Examining team's comments. Answers to part (a) were, on the whole, disappointing. The majority of candidates who attempted this part (and some candidates did not) referred to the requirements of IAS 27 – which no longer deals with consolidated financial statements. It is clearly important to ensure that technical knowledge is updated when standards change. A number of candidates incorrectly concluded that Gamma was not a subsidiary but an associate and then proceeded to treat Gamma as such in part (b) despite clear instructions on the exam to treat Gamma as a subsidiary in part (b). It is important that candidates read the question requirements carefully.

[References: IFRS 10: paras. 7–18]

Marking scheme

	Marks
(a) Discussion of status of investment in Gamma	
Under the principles of IFRS 10 <i>Consolidated Financial Statements</i> Gamma became a subsidiary of Alpha on 1 July 20X3 if Alpha obtained control of Gamma on that date.	1
IFRS 10 states that an investor controls an investee if and only if the investor has:	
Power over the investee. Given the absolute size of its shareholding relative to the other shareholdings and the absence of any collective agreements between the other shareholders, it would appear that Alpha does indeed have power over Gamma.	1½
Exposure to variable returns from its involvement with the investee. Alpha's shareholding will entitle Alpha to dividends which will vary with the level of Gamma's profits.	1
Ability to use its power to affect those returns. Given its effective control of the board of directors, Alpha is able to control the operating and financial policies of Gamma which will affect its profits and in turn its dividends.	1
Therefore Gamma would be regarded as a subsidiary of Alpha from 1 July 20X3.	½
	<u>5</u>

		Marks
(b)	CONSOLIDATED STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME OF ALPHA FOR THE YEAR ENDED 31 MARCH 20X4	
	\$'000	
Revenue (W1)	928,000	2½
Cost of sales (bal fig)	(527,200)	½
Gross profit (W2)	400,800	7½
Distribution costs (Alpha + Beta + 9/12 × Gamma)	(46,500)	½
Administrative expenses (W4)	(93,500)	2½
Finance costs (W5)	(49,650)	4½
Investment income (33,000 – 80% × 30,000 – 40% × 20,000)	1,000	½ + ½ + ½
Profit before tax	212,150	
Income tax expense (W8)	(62,700)	3
Profit for the year	149,450	
Other comprehensive income:		
Items that will not be reclassified to profit or loss		
Gain on property revaluation (W9)	27,750	2
Actuarial loss on defined benefit retirement benefit plan (W10)	(900)	3
Items that will subsequently be reclassified to profit or loss		½
Cash flow hedges	3,600	1
Total comprehensive income for the year	179,900	
Profit attributable to:		
Owners of the parent (bal fig)	115,760	½
Non-controlling interests (W11)	33,690	3½
	149,450	
	\$'000	
Total comprehensive income attributable to:		
Owners of the parent (bal fig)	140,810	½
Non-controlling interests (W12)	39,090	1½
	179,900	
		35
		40

Workings – Do not double count marks.

All numbers in \$'000 unless otherwise stated

1 Revenue

	\$'000	
Consolidate Alpha + Beta + 9/12 × Gamma		1
Alpha + Beta + 9/12 × Gamma	974,000	½
Sales of components by Alpha to Beta	(30,000)	½
Sale of machine by Alpha to Beta	(16,000)	½
	928,000	2½

2 Gross profit

	\$'000	
Alpha + Beta + 9/12 × Gamma	416,000	½
Movement in unrealised profit on sale of components:		
¼ (6,000 – 4,400)	(400)	1½
Unrealised profit on the sale of machine: (16,000 – 12,000)	(4,000)	½
Add back excess depreciation on sale of machine:	1,000	½
Extra depreciation of Gamma's plant:		
(78,000 – 70,000) × ¼ × 9/12	(1,500)	1
Extra amortisation of Gamma's development project:		
(22,000 – 10,000) × 1/10 × 3/12	(300)	1
Impairment of goodwill on acquisition of Beta (W3)	(10,000)	2½ (W3)
	400,800	7½



Marks

3	<i>Impairment of Beta goodwill</i>				
		<i>Unit 1</i>	<i>Unit 2</i>	<i>Unit 3</i>	
		\$'000	\$'000	\$'000	
	Carrying amount of net assets	215,000	185,000	130,000	½
	Allocated goodwill	32,000	28,000	20,000	1
		<u>247,000</u>	<u>213,000</u>	<u>150,000</u>	
	Recoverable amount	255,000	220,000	140,000	½
	So impairment equals	<u>Nil</u>	<u>Nil</u>	<u>10,000</u>	½
					<u>2½</u>
					⇒W2
4	<i>Administrative expenses</i>			\$'000	
	Alpha + Beta + $9/12 \times$ Gamma			93,000	½
	Current service cost – defined benefit retirement benefit plan			4,500	1
	Decrease in fair value of contingent liability of Gamma (16,000 – 12,000)			<u>(4,000)</u>	1
	(Also acceptable to show as other income or adjustment to cost of sales)			<u>93,500</u>	2½
5	<i>Finance costs</i>			\$'000	
	Alpha + Beta + $9/12 \times$ Gamma			44,000	½
	Finance cost on deferred consideration (W6)			4,050	2 (W6)
	Finance cost on defined benefit retirement benefit plan (W7)			1,600	2 (W7)
				<u>49,650</u>	4½
6	<i>Finance cost on deferred consideration</i>			\$'000	
	Present value of future payment ($65,340/(1.10)^2$)			<u>54,000</u>	1
	Annual finance cost (10%)			<u>5,400</u>	½
	Finance cost for nine month period			<u>4,050</u>	½
					<u>2</u>
					⇒W5
7	<i>Finance cost on defined benefit retirement benefit plan</i>			\$'000	
	Opening net liability (60,000 – 40,000)			<u>20,000</u>	1
	Annual finance cost (8%)			<u>1,600</u>	1
					<u>2</u>
					⇒W5
8	<i>Income tax expense</i>			\$'000	
	Alpha + Beta + $9/12 \times$ Gamma			64,000	½
	Deferred tax consolidation adjustments:				
	– PURP on components ($25\% \times 400$)			(100)	½
	– Unrealised profit on sale of machine ($25\% \times 3,000$)			(750)	½
	– Fair value adjustments ($25\% (1,500 + 300)$)			(450)	1
	– Impairment of goodwill (outside scope)			<u>Nil</u>	½
				<u>62,700</u>	3
9	<i>Gain on property revaluation</i>			\$'000	
	Alpha + whole of Gamma (all post-acquisition)			37,000	1
	Deferred tax on gain (25%)			<u>(9,250)</u>	1
				<u>27,750</u>	2



			Marks
10	Actuarial loss on defined benefit retirement benefit plan		
		\$'000	
	Opening net liability (60,000 – 40,000)	20,000	½
	Current service cost	4,500	½
	Finance cost on net liability (W7)	1,600	½
	Contributions	(5,000)	½
		<u>21,100</u>	
	Closing net liability (68,000 – 46,000)	(22,000)	½
	Actuarial loss (balancing figure)	<u>900</u>	½
			<u>3</u>
11	Non-controlling interests in profit		
		\$'000	
	Beta		
	Profit for the year	60,000	½
	Excess depreciation on sale of machine (W2)	<u>1,000</u>	
	Impairment of goodwill	(10,000)	½
		<u>51,000</u>	
	NCI (20%)	10,200	½
	Gamma		
	9/12 × profit for the year	40,500	½
	Fair value adjustments (1,500 + 300 (W2))	(1,800)	½
	Deferred tax on fair value adjustments (25% × 1,800)	<u>450</u>	½
		<u>39,150</u>	
	NCI (60%)	<u>23,490</u>	½
		<u>33,690</u>	<u>3½</u>
12	Non-controlling interests in total comprehensive income		
		\$'000	
	NCI in profit (W11)	33,690	½
	NCI in Gamma's property revaluation (60% × (12,000 × 75% – the net of tax amount))	<u>5,400</u>	1
		<u>39,090</u>	<u>1½</u>

63 Aran Group (12/14) (amended)

Top tips. This is a typical group accounting question and at first sight it may look difficult. As usual, you should work methodically, taking each issue in turn. Always provide full and clear workings and reference each working to your main answer. The more simple workings can be done on the face of the statement of profit or loss. If you have practised similar questions, you should be able to make a good attempt at this one. In this question, the main issues are:

- Impairment of goodwill (Merino)
- Acquisition and subsequent disposal of a subsidiary during the year (Cashmere)
- Inter-group trading
- Post-employment benefits
- A restructuring, including recognising a provision
- An issue of convertible bonds
- Financial assets (this is straightforward)
- A forward currency contract (hedging)

Remember to leave enough time to complete the summarised statement of changes in equity, which is worth 8 marks. You need to calculate opening retained earnings and non-controlling interest, but these are relatively simple calculations.

Easy marks. As usual, there are easy marks for slotting the simpler figures into the two statements, or for some simple addition.

Examining team's comments. A reasonable minority of candidates made one or more of the following 'basic' consolidation errors when answering part (b):

- Using proportional consolidation for both subsidiaries
- Failing to time-apportion the profits of Cashmere or time-apportioning the profits for the wrong number of months
- Deducting unrealised profits on intra-group sales from consolidated revenues
- Reflecting the unrealised profit on intra-group sales when computing the non-controlling interest in Merino and Cashmere when the sales were made by Aran, the parent

Marking scheme

Marks

(a) **Computation of goodwill on acquisition of Cashmere**

	\$'000	\$'000	Explanations (where needed)	
Cost of investment:		120,000		½
Non-controlling interest at the date of acquisition		<u>28,000</u>		½
		148,000		
Net assets at the date of acquisition				
Share capital	75,000			½
Retained earnings	36,300			½
Fair value uplifts	<u>27,200</u>		\$20 million + \$7.2 million as per Note 2	1
		<u>(138,500)</u>		
Goodwill on acquisition		<u>9,500</u>		<u>1</u> <u>4</u>

(b) **ARAN CONSOLIDATED STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 30 SEPTEMBER 20X4**

	\$'000	
Revenue (W1)	563,000	1½ (W1)
Cost of sales (W2)	<u>(288,360)</u>	8½ (W2)
Gross profit	274,640	
Distribution costs (20,000 + 15,000 + 13,500 × 8/12)	(44,000)	½
Administrative expenses (W4)	(57,600)	1½ (W4)
Redundancy and reorganisation costs (W5)	(10,000)	1½ (W5)
Investment income (W6)	6,100	1½ (W6)
Finance costs (W7)	(53,414)	4½ (W7)
Profit on disposal of subsidiary (W12)	<u>3,472</u>	4 (W15)
Profit before tax	119,118	
Income tax expense (14,000 + 10,000 + 8/12 × 12,000)	<u>(32,000)</u>	½
Profit for the year	87,198	
Other comprehensive income:		

	\$'000	Marks
Items that will not be reclassified to profit and loss		
Gains on financial assets designated at fair value through other comprehensive income (9,000 + 1,400)	10,400	1
Actuarial loss on defined benefit retirement benefits plan (W9)	(150)	4 (W9)
Items that may be reclassified subsequently to profit or loss:		$\frac{1}{2}$
Cash flow hedges	(1,100)	1
Total comprehensive income for the year	<u>96,348</u>	
 Profit attributable to:		
Owners of Aran (balancing figure)	76,016	$\frac{1}{2}$
Non-controlling interest (W10)	<u>11,182</u>	3 (W10)
	<u>87,198</u>	
 Total comprehensive income attributable to:		
Owners of Aran (balancing figure)	84,886	$\frac{1}{2}$
Non-controlling interest (W11)	<u>11,462</u>	$1\frac{1}{2}$ (W11)
	<u>96,348</u>	
		<u>36</u>

Workings – Do not double count marks.

All numbers in \$'000 unless otherwise stated.

1	Revenue					
			\$'000			
	Aran + Merino + $8/12 \times$ Cashmere		580,000		$\frac{1}{2}$	
	Intra-group revenue (12,000 + 5,000)		<u>(17,000)</u>		$\frac{1}{2} + \frac{1}{2}$	
			<u>563,000</u>		<u>$1\frac{1}{2}$</u>	
2	Cost of sales					
			\$'000			
	Aran + Merino + $8/12 \times$ Cashmere		300,000		$\frac{1}{2}$	
	Intra-group purchases (as W1)		<u>(17,000)</u>		$\frac{1}{2}$	
	Unrealised profit:					
	Closing inventory ($25/125 \times (2,400 + 2,000)$)		880		1	
	Opening inventory ($25/125 \times 1,800$)		<u>(360)</u>		$\frac{1}{2} + \frac{1}{2}$	
	Impairment of Merino goodwill (W3)		3,000		$3\frac{1}{2}$	
	Extra depreciation on fair value adjustments:					
	Property ($(20,000 - 11,000) \times 1/25 \times 8/12$)		240		1	
	Plant and equipment ($7,200 \times 1/3 \times 8/12$)		<u>1,600</u>		1	
			<u>288,360</u>		<u>$8\frac{1}{2}$</u>	
3	Impairment of Merino goodwill					
		Unit 1	Unit 2	Unit 3	Unit 4	$\frac{1}{2}$
		\$'000	\$'000	\$'000	\$'000	
	Carrying amount					
	(excluding goodwill)	45,000	55,000	30,000	30,000	$\frac{1}{2}$
	Allocated goodwill	8,000	4,000	3,000	3,000	$\frac{1}{2}$
		53,000	59,000	33,000	33,000	
	Recoverable amount	<u>50,000</u>	<u>65,000</u>	<u>35,000</u>	<u>35,000</u>	
	So impairment equals	<u>3,000</u>	<u>Nil</u>	<u>Nil</u>	<u>Nil</u>	$\frac{1}{2} + \frac{1}{2} + \frac{1}{2} + \frac{1}{2}$
						<u>$3\frac{1}{2}$</u>
						\Rightarrow W2
4	Administrative expenses					
			\$'000			
	Aran + Merino + $8/12 \times$ Cashmere		57,000		$\frac{1}{2}$	
	Contributions to defined benefit plan incorrectly charged		<u>(5,400)</u>		$\frac{1}{2}$	
	Current service cost of defined benefit plan		6,000		$\frac{1}{2}$	
			<u>57,600</u>		<u>$1\frac{1}{2}$</u>	



5	Redundancy and reorganisation costs			Marks
		\$'000		
	Redundancy costs (valid as constructive obligation at year end)	10,000		½
	Cost of new staff training (on-going costs cannot be included)	Nil		½
	Expected profit on the sale of assets (cannot include)	Nil		½
		<u>10,000</u>		<u>1½</u>
6	Investment income			
		\$'000		
	Aran + 8/12 × Cashmere	13,600		½
	Intra-group dividends eliminated:			
	– Merino (75% × 10,000)	(7,500)		½
	– Cashmere (paid pre-acquisition)	Nil		½
		<u>6,100</u>		<u>1½</u>
7	Finance cost			
		\$'000		
	Aran + Merino + 8/12 × Cashmere	49,000		½
	Reversal of interest paid on convertible loan incorrectly recognised			
	as a finance cost (300,000 × 5%)	(15,000)		1
	Correct finance cost on convertible loan (W8)	19,164	2½ (W8)	
	Interest cost on net defined benefit plan liability (W9)	250		½
		<u>53,414</u>		<u>4½</u>
8	Finance cost on convertible loan			
		\$'000		
	Liability element of loan (15,000 × 6.71 + 300,000 × 0.463)	<u>239,550</u>	½ + ½ + ½ + ½	
	So appropriate finance cost = 8% × 239,550	19,164	½	
			<u>2½</u>	
			⇒ W7	
9	Actuarial loss on defined benefits retirement benefits plan			
		Liability	Asset	Net
		\$'000	\$'000	\$'000
	Opening balance	32,000	(27,000)	5,000
	Current service cost	6,000		6,000
	Interest cost (5%)	1,600	(1,350)	250
	Benefits paid	(2,000)	2,000	Nil
	Contributions paid		(5,400)	(5,400)
	Actuarial loss (gain) – balancing figure	2,400	(2,250)	150
	Closing balance	<u>40,000</u>	<u>(34,000)</u>	<u>6,000</u>
				<u>4</u>
10	Non-controlling interest in profit			
		Merino	Cashmere	Total
		\$'000	(8/12)	\$'000
	Profit after tax	30,000	24,000	
	Extra depreciation – Cashmere (240 + 1,600 (W2))	Nil	(1,840)	
	Impairment of Merino goodwill (W3)	(3,000)		
	Relevant profit	<u>27,000</u>	<u>22,160</u>	
	Non-controlling interest (25%/20%)	<u>6,750</u>	<u>4,432</u>	<u>11,182</u>
				½ + ½
				<u>3</u>

11	<i>Non-controlling interest in total comprehensive income</i>		
		\$'000	
	Non-controlling interest in profit (W10)	11,182	½
	Non-controlling interest in Merino's other comprehensive income (20% × 1,400)	280	½ + ½
		<u>11,462</u>	<u>1½</u>
12	<i>Profit on disposal of Cashmere</i>		
		\$'000	
	Fair value of consideration received	126,000	1
	Less: share of consolidated carrying amount at date of disposal		
	Net assets	145,460	1
	Goodwill (part a)	9,500	½
	less non-controlling interests (28,000 + 4,432 (W10))	<u>(32,432)</u>	<u>1½</u>
		<u>(122,528)</u>	
	Profit/(loss) on disposal	<u>3,472</u>	<u>4</u>

64 Abiola (6/17)

Top tips. This is a typical group accounting question and at first sight it may look difficult. As usual, you should work methodically, taking each issue in turn. Always provide full and clear workings and reference each working to your main answer. The more simple workings can be done on the face of the statement of profit or loss. If you have practised similar questions, you should be able to make a good attempt at this one. In this question, the main issues are:

- Calculation of goodwill involving a share exchange and deferred and contingent consideration (Cuca)
- Impairment of goodwill (Busayo)
- Acquisition of a subsidiary during the year (Cuca)
- Inter-group trading
- Revenue from a service contract
- Issue of a convertible bond

Remember to leave enough time to complete the summarised statement of changes in equity, which is worth 7 marks. You need to calculate opening equity and non-controlling interest, but these are relatively simple calculations.

Easy marks. As usual, there are easy marks for slotting the simpler figures into the two statements, or for some simple addition.

Examining team's comments. Calculation of goodwill and its impairment was the most challenging component of this question. The goodwill calculations in this question are fairly typical calculations that should be practiced in advance of the exam.

Common errors highlighted in the examiner's report for part (b) include:

- Incorrectly calculating the impairment of Busayo's goodwill due to not grossing up the goodwill in order to compare it to the recoverable amount of Busayo. The examiner commented that this is tested frequently in the DipIFR exam.
- Failing to show the non-controlling interest in profits and total comprehensive income.

- Incorrectly calculating the liability element of the convertible loan by discounting the amount upon issue rather than the amount on redemption.
- Incorrectly using mark-up, rather than margin in calculating the unrealised profit.

Not all candidates attempted the preparation of the consolidated statement of changes in equity in part (c), thereby forfeiting 7 marks.

Marking scheme

Marks

(a) **Computation of goodwill on acquisition of Busayo and Cuca**

	\$'000	\$'000	Explanations (where needed)	
Busayo				
Cost of investment:				
Cash paid		64,000		½
Non-controlling interest at the date of acquisition		14,000	20% of the net assets	1
Net assets at the date of acquisition		<u>(70,000)</u>		½
Goodwill on acquisition of Busayo		<u>8,000</u>		
Cuca				
Cost of investment:				
Share exchange	56,000		50 million × 60% × 2/3 = 20 million shares issued at \$2.80	1
Deferred cash consideration	20,000		\$24.2 million/(1.10) ² – the present value of the cash payable	1
Contingent consideration	<u>40,000</u>		Measured at fair value at the date of acquisition	1
		116,000		
Non-controlling interest at the date of acquisition		<u>74,000</u>	50 million × 40% = 20 million shares at \$3.70	1
		190,000		
Net assets at the date of acquisition				
At 1 April 20X5	130,000		As per Cuca's financial statements	½
Profits to 30 September 20X5	16,500		6/12 of the profits for the year to 31 March 20X6	1
Fair value uplifts	<u>33,000</u>		\$25 million + \$8 million as per Note 2	½
		<u>(179,500)</u>		
Goodwill on acquisition of Cuca		<u>10,500</u>		
				<u>8</u>



(b) CONSOLIDATED STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME OF ABIOLA FOR THE YEAR ENDED 31 MARCH 20X6

	\$'000	
Revenue (W1)	639,200	3½ (W1)
Cost of sales (W3)	(381,955)	8 (W3)
Gross profit	257,245	
Distribution costs (20,000 + 16,000 + 15,000 × 6/12)	(43,500)	½
Administrative expenses (30,000 + 19,000 + 18,000 × 6/12)	(58,000)	½
Investment income (W5)	3,600	1½ (W5)
Finance costs (W6)	(61,000)	4 (W6)
Profit before tax	98,345	
Income tax expense (15,000 + 12,000 + 6/12 × 11,000)	(32,500)	½
Profit for the year	65,845	
<i>Other comprehensive income</i>		
Items that will not be reclassified to profit and loss		
Losses on financial assets designated at fair value through other comprehensive income (40,000 – 37,000)	(3,000)	1
Gains on derivatives classified as effective fair value hedges (8,700 – 6,000)	2,700	1
<i>Total comprehensive income for the year</i>	<u>65,545</u>	
Profit attributable to:		
Owners of Abiola (balancing figure)	52,595	½
Non-controlling interest (W9)	13,250	3 (W9)
	<u>65,845</u>	
Total comprehensive income attributable to:		
Owners of Abiola (balancing figure)	52,295	½
Non-controlling interest (as above)	13,250	½
	<u>65,545</u>	
		<u>25</u>

(c) CONSOLIDATED STATEMENT OF CHANGES IN EQUITY OF ABIOLA FOR THE YEAR ENDED 31 MARCH 20X6

	Abiola group	Non-controlling interest	Total	
	\$'000	\$'000	\$'000	
At 1 April 20X5 (W10/11)	263,800 (W10)	30,000 (W11)	293,800	2 (W10) + ½ (W11)
Increase due to acquisition	56,000	74,000	130,000	½ + ½
Equity element of bond issue (W12)	25,000		25,000	1 (W12)
Comprehensive income for the year	52,295	13,250	65,545	½ + ½
Dividends paid	(30,000)	(6,800) (W13)	(36,800)	½ + 1 (W13)
At 31 March 20X6	<u>367,095</u>	<u>110,450</u>	<u>477,545</u>	
				<u>7</u>
				<u>40</u>

Workings – All numbers in \$'000 unless otherwise stated

1 Revenue

	\$'000	
Abiola + Busayo + 6/12 × Cuca	665,000	½
Intra-group revenue (15,000 + 8,000)	(23,000)	½
Deferred service revenue (W2)	(2,800)	2½ (W2)
	<u>639,200</u>	<u>3½</u>

Marks

2	Deferred service revenue		
		\$'000	
	Actual price of 'package' (A)	51,200	½
	Sum of fair values of individual components (60,000 + 4 × 1,000) (B)	64,000	½
	A/B	80%	½
	So 'service revenue' (4 × 1,000 × 80%)	3,200	½
	Amount deferred (42/48)	2,800	½
		<u>2½</u>	
			⇒ W1
3	Cost of sales		
		\$'000	
	Abiola + Busayo + 6/12 × Cuca	400,000	½
	Intra-group purchases (as W1)	(23,000)	½
	Unrealised profit:		
	Closing inventory (10% × (3,000 + 2,800))	580	1
	Opening inventory (10% × 2,000)	(200)	½ + ½
	Impairment of Busayo goodwill (W4)	3,200	3 (W4)
	Extra depreciation on fair value adjustments:		
	Property ((25,000 – 10,000) × 1/20 × 6/12)	375	1
	Plant and equipment (8,000 × 1/4 × 6/12)	1,000	1
		<u>381,955</u>	<u>8</u>
4	Impairment of Busayo goodwill		
		\$'000	
	Net assets at 31 March 20X6	174,000	½
	Grossed up goodwill (8,000 × 100/80)	10,000	½ + ½
		<u>184,000</u>	
	Recoverable amount	(180,000)	½
	So gross impairment	4,000	½
	Recognise group share (80%)	3,200	½
		<u>3</u>	
			⇒ W3
5	Investment income		
		\$'000	
	Abiola	19,800	½
	Intra-group dividends eliminated:		
	– Busayo (80% × 12,000)	(9,600)	½
	– Cuca (paid post-acquisition – 60% × 11,000)	(6,600)	½
		<u>3,600</u>	<u>1½</u>
6	Finance cost		
		\$'000	
	Abiola + Busayo + 6/12 × Cuca	35,500	½
	Change in fair value of contingent consideration (42,000 – 40,000)	2,000	1
	Finance cost on deferred consideration (W7)	1,000	1 (W7)
	Finance cost on convertible bond (W8)	22,500	1½ (W8)
		<u>61,000</u>	<u>4</u>

Tutorial note. It would be acceptable to show the change in fair value of the contingent consideration under a reasonable alternative expense heading, such as administrative expenses.

Marks

7	Finance cost on deferred consideration			
		\$'000		
	20,000 (amount included in goodwill calculation) \times 10% \times 6/12	<u>1,000</u>		1
				= W6
8	Finance cost on convertible bond			
		\$'000		
	Liability element of convertible loan (362,320 \times 0.621)	<u>225,000</u>		1
	So appropriate finance cost = 10% \times 225,000	<u>22,500</u>		$\frac{1}{2}$
				$\frac{1}{2}$
				= W6
9	Non-controlling interest in profit			
		Busayo	Cuca (6/12)	Total
		\$'000	\$'000	\$'000
	Profit after tax	36,000	16,500	
	Extra depreciation – Cuca (375 + 1,000 (W3))		<u>(1,375)</u>	$\frac{1}{2} + \frac{1}{2}$
	Relevant profit	<u>36,000</u>	<u>15,125</u>	
	Non-controlling interest (20%/40%)	<u>7,200</u>	<u>6,050</u>	<u>13,250</u>
				$\frac{1}{2} + \frac{1}{2}$
				3
10	Opening equity – Abiola group			
			\$'000	
	Abiola		200,000	$\frac{1}{2}$
	Busayo: 80% \times (150,000 – 70,000)		64,000	$\frac{1}{2} + \frac{1}{2}$
	Opening provision for unrealised profit (W2)		<u>(200)</u>	$\frac{1}{2}$
			<u>263,800</u>	<u>2</u>
11	Opening non-controlling interest (in Busayo)			
			\$'000	
	20% \times 150,000		<u>30,000</u>	$\frac{1}{2}$

Tutorial note. An alternative computation would be:

	\$'000	
At date of acquisition (20% \times 70,000)	14,000	$\frac{1}{2}$
Increase since acquisition: 20% (150,000 – 70,000)	<u>16,000</u>	$\frac{1}{2}$
At start of the year	<u>30,000</u>	<u>1</u>

12	Equity element of bond issue		
		\$'000	
	Total proceeds	250,000	$\frac{1}{2}$
	Loan element (W7)	<u>(225,000)</u>	$\frac{1}{2}$
	So equity element equals	<u>25,000</u>	<u>1</u>
13	Dividends paid to non-controlling interest		
		\$'000	
	Busayo (12,000 \times 20%)	2,400	$\frac{1}{2}$
	Cuca (11,000 \times 40%)	<u>4,400</u>	$\frac{1}{2}$
	Total	<u>6,800</u>	<u>1</u>

ACCA Diploma in International Financial Reporting BPP Mock Exam 1 (December 2016 exam)

Questions	
Time allowed	3 hours and 15 minutes
ALL FOUR questions are COMPULSORY and must be attempted	

DO NOT OPEN THIS EXAM UNTIL YOU ARE READY TO START UNDER EXAMINATION CONDITIONS

Question 1

Alpha holds investments in two entities, Beta and Gamma. The draft statements of financial position of the three entities at 30 September 20X6 were as follows:

	<i>Alpha</i> \$'000	<i>Beta</i> \$'000	<i>Gamma</i> \$'000
Assets			
Non-current assets			
Property, plant and equipment (Notes 1 and 3)	524,000	370,000	162,000
Investments (Notes 1 and 3)	423,000	Nil	Nil
	<u>947,000</u>	<u>370,000</u>	<u>162,000</u>
Current assets			
Inventories	120,000	75,000	60,000
Trade receivables (Note 4)	90,000	66,000	55,000
Cash and cash equivalents	15,000	12,000	10,000
	<u>225,000</u>	<u>153,000</u>	<u>125,000</u>
Total assets	<u>1,172,000</u>	<u>523,000</u>	<u>287,000</u>
Equity and liabilities			
Equity			
Share capital (\$1 shares)	140,000	100,000	80,000
Retained earnings (Notes 1 and 3)	573,000	210,000	90,000
Other components of equity (Notes 1 and 3)	250,000	10,000	Nil
Total equity	<u>963,000</u>	<u>320,000</u>	<u>170,000</u>
Non-current liabilities			
Provisions (Note 5)	1,250	Nil	Nil
Long-term borrowings	82,750	90,000	48,000
Deferred tax	45,000	28,000	30,000
Total non-current liabilities	<u>129,000</u>	<u>118,000</u>	<u>78,000</u>
Current liabilities			
Trade and other payables	60,000	50,000	30,000
Short-term borrowings	20,000	35,000	9,000
Total current liabilities	<u>80,000</u>	<u>85,000</u>	<u>39,000</u>
Total equity and liabilities	<u>1,172,000</u>	<u>523,000</u>	<u>287,000</u>

Notes

1 Alpha's investment in Beta

On 1 October 20X3, Alpha acquired 80 million shares in Beta by means of a share exchange of one share in Alpha for every two shares acquired in Beta. On 1 October 20X3, the market value of an Alpha share was \$7.00.

Alpha incurred directly attributable due diligence costs of \$3 million on acquisition of Beta. The directors of Alpha included these acquisition costs in the carrying amount of the investment in Beta in the draft statement of financial position of Alpha. There has been no change to the carrying amount of this investment in Alpha's own statement of financial position since 1 October 20X3.

On 1 October 20X3, the individual financial statements of Beta showed the following balances:

- Retained earnings \$150 million
- Other components of equity \$5 million

The directors of Alpha carried out a fair value exercise to measure the identifiable assets and liabilities of Beta at 1 October 20X3. The following matters emerged:

- Property having a carrying amount of \$160 million (land component \$70 million, buildings component \$90 million) had an estimated fair value of \$200 million (land component \$80 million, buildings component \$120 million). The buildings component of the property had an estimated useful life of 30 years at 1 October 20X3.

- Plant and equipment having a carrying amount of \$120 million had an estimated fair value of \$140 million. The estimated remaining useful life of this plant at 1 October 20X3 was four years. None of this plant and equipment had been disposed of between 1 October 20X3 and 30 September 20X6.
- On 1 October 20X3, the notes to the financial statements of Beta disclosed a contingent liability. On 1 October 20X3, the fair value of this contingent liability was reliably measured at \$6 million. The contingency was resolved in the year ended 30 September 20X4 and no payments were required to be made by Beta in respect of this contingent liability.
- The fair value adjustments have not been reflected in the individual financial statements of Beta. In the consolidated financial statements the fair value adjustments will be regarded as temporary differences for the purposes of computing deferred tax. The rate of deferred tax to apply to temporary differences is 20%.

The directors of Alpha used the proportion of net assets method when measuring the non-controlling interest in Beta in the consolidated statement of financial position.

2 *Impairment review of goodwill on acquisition of Beta*

No impairment of the goodwill on acquisition of Beta was evident when the reviews were carried out on 30 September 20X4 and 20X5. On 30 September 20X6, the directors of Alpha carried out a further review and concluded that the recoverable amount of the net assets of Beta at that date was \$400 million. Beta is regarded as a single cash generating unit for the purpose of measuring goodwill impairment.

3 *Alpha's investment in Gamma*

On 1 October 20X5, Alpha acquired 60 million shares in Gamma by means of a cash payment of \$140 million. The purchase agreement provided for an additional payment on 31 October 20X7 to the former holders of the 60 million acquired shares. The amount of this additional payment is dependent on the financial performance of Gamma in the two-year period from 1 October 20X5 to 30 September 20X7. On 1 October 20X5, the fair value of this additional payment was estimated to be \$20 million. This estimate was revised to \$24 million on 30 September 20X6. Alpha has not made any entries in its draft financial statements to record this potential additional payment.

On 1 October 20X5, the individual financial statements of Gamma showed a balance on retained earnings of \$75 million.

On 1 October 20X5, the fair values of the net assets of Gamma were the same as their carrying amounts with the exception of some land which had a carrying amount of \$50 million and a fair value of \$70 million. This land continued to be an asset of Gamma at 30 September 20X6. The fair value adjustment has not been reflected in the individual financial statements of Gamma. In the consolidated financial statements the fair value adjustment will be regarded as a temporary difference for the purposes of computing deferred tax. The rate of deferred tax to apply to temporary differences is 20%.

No impairment issues arose concerning the measurement of Gamma in the consolidated statement of financial position of Alpha at 30 September 20X6.

The directors of Alpha used the full goodwill (fair value) method when measuring the non-controlling interest in Gamma in the consolidated statement of financial position. On 1 October 20X5, the fair value of a share in Gamma was \$2.30.

4 *Trade receivables and payables*

Group policy is to clear intra-group balances on a given date prior to each year end. Beta complied with this policy at 30 September 20X6 but Gamma was late in making the required payment of \$10 million to Alpha. The payment was made by Gamma on 29 September 20X6 and received and recorded by Alpha on 2 October 20X6.

5 *Provision*

On 1 October 20X5, Alpha completed the construction of a non-current asset with an estimated useful life of 20 years. The costs of construction were recognised in property, plant and equipment and depreciated appropriately. Alpha has a legal obligation to restore the site on which the non-current asset is located on 30 September 2025. The estimated cost of this restoration work, at 30 September 2025 prices, is \$25 million. The directors of Alpha have made a provision of \$1.25 million ($1/20 \times \25 million) in the draft statement of financial position at 30 September 20X6. An appropriate annual discount rate to use in any relevant calculations is 6% and at this rate the present value of \$1 payable in 20 years is 31.2 cents.

Required

Prepare the consolidated statement of financial position of Alpha at 30 September 20X6. You need only consider the deferred tax implications of any adjustments you make where the question specifically refers to deferred tax.

(Total = 40 marks)

Question 2

Delta is an entity which prepares financial statements to 30 September each year. The financial statements for the year ended 30 September 20X6 are shortly to be authorised for issue. The following events are relevant to these financial statements:

- (a) On 1 October 20X4, Delta purchased an asset for \$20 million. The estimated useful life of the asset was ten years, with an estimated residual value of zero. Delta immediately leased the asset to Epsilon. The lease term was ten years and the annual rental, payable in advance by Epsilon, was \$2,787,000. Delta incurred direct costs of \$200,000 in arranging the lease. The lease contained no early termination clauses and responsibility for repairs and maintenance of the asset rest with Epsilon for the duration of the lease. The directors of Delta correctly computed the annual rate of interest implicit in the lease as 8%. At an annual discount rate of 8% the present value of \$1 receivable at the start of years 1–10 is \$7.247. **(8 marks)**
- (b) On 1 September 20X6, Delta sold a product to Customer X. Customer X is based in a country whose currency is the florin and Delta has a large number of customers in that country to whom Delta sell similar products. The invoiced price of the product was 500,000 florins. The terms of the sale gave the customer the right to return the product at any time in the two-month period ending on 31 October 20X6. On 1 September 20X6, Delta estimated that there was a 22% chance the product would be returned during the two-month period. The product had not been returned to Delta by 15 October 20X6 (the date the financial statements for the year ended 30 September 20X6 were authorised for issue). On 15 October 20X6, the directors estimated that there was an 8% chance the product would be returned before 31 October 20X6. The directors of Delta considered that the most reliable method of measuring the price for this transaction was to estimate any variable consideration using a probability (expected value) approach. Exchange rates (florins to \$1) are as follows:
- 1 September 20X6 – 2 florins to \$1
 - 30 September 20X6 – 2.1 florins to \$1
 - 15 October 20X6 – 2.15 florins to \$1
 - 31 October 20X6 – 2.2 florins to \$1
- (7 marks)**
- (c) On 1 October 20X4, Delta granted 250 share appreciation rights to 100 senior executives. The rights vest on 30 September 20X7 provided the executives remain with Delta for the three-year period from 1 October 20X4 to 30 September 20X7. The rights can be exercised from 30 November 20X7 to 31 December 20X7. On 1 October 20X4, it was expected that ten executives would leave over the three-year period from 1 October 20X4 to 30 September 20X7. This estimate was confirmed on 30 September 20X5 but two executives left unexpectedly during the year ended 30 September 20X6 and Delta now expects that 12 executives will leave over the three-year period ending on 30 September 20X7. Delta further estimated that all executives who were eligible to exercise the rights would do so. On 1 October 20X4, the fair value of a share appreciation right was \$3.20. The fair value increased to \$3.50 by 30 September 20X5 and to \$3.60 by 30 September 20X6. **(5 marks)**

Required

Explain and show how the three events would be reported in the financial statements of Delta for the year ended 30 September 20X6.

Notes

- 1 The mark allocation is shown against each of the three events above.
- 2 In explaining event (b), you do not need to consider the impact on inventory and cost of sales.

(Total = 20 marks)

Question 3

- (a) One of the matters addressed in IFRS 9 *Financial Instruments* is the initial and subsequent measurement of financial assets. IFRS 9 requires that financial assets are initially measured at their fair value at the date of initial recognition. However, subsequent measurement of financial assets depends on their classification for which IFRS 9 identifies three possible alternatives.

Required

Explain the three classifications which IFRS 9 identifies for financial assets and the basis of measurement which is appropriate for each classification. You should also identify any exceptions to the normal classifications which may apply in specific circumstances. **(8 marks)**

- (b) Kappa prepares financial statements to 30 September each year. During the year ended 30 September 20X6 Kappa entered into the following transactions:
- (i) On 1 October 20X5, Kappa made an interest free loan to an employee of \$800,000. The loan is due for repayment on 30 September 20X7 and Kappa is confident that the employee will repay the loan. Kappa would normally require an annual rate of return of 10% on business loans. **(5 marks)**
 - (ii) On 1 October 20X5, Kappa made a three-year loan of \$10 million to entity X. The rate of interest payable on the loan was 8% per annum, payable in arrears. On 30 September 20X8, Kappa will receive a fixed number of shares in entity X in full settlement of the loan. Entity X paid the interest due of \$800,000 on 30 September 20X6 and entity X has no liquidity problems. Following payment of this interest, the fair value of this loan asset at 30 September 20X6 was estimated to be \$10.5 million. **(4 marks)**
 - (iii) On 1 October 20X5, Kappa purchased an equity investment in entity Y for \$12 million. The investment did not give Kappa control or significant influence over entity Y but the investment is seen as a long-term one. On 30 September 20X6, the fair value of Kappa's investment in entity Y was estimated to be \$13 million. **(3 marks)**

Required

Explain and show how the above transactions would be reported in the financial statements of Kappa for the year ended 30 September 20X6.

Note. The mark allocation for part (b) is shown against each of the three transactions above.

(Total = 20 marks)

Question 4

You are the financial controller of Omega, a listed entity which prepares consolidated financial statements in accordance with International Financial Reporting Standards (IFRS). You have recently produced the final draft of the financial statements for the year ended 30 September 20X6 and these are due to be published shortly. The managing director, who is not an accountant, reviewed these financial statements and prepared a list of queries arising out of the review.

Query One

One of the notes to the financial statements gives details of purchases made by Omega from entity X during the period. I own 100% of the shares in entity X but I do not understand why it is necessary for any disclosure whatsoever to be made in the Omega financial statements. The transaction is carried out on normal commercial terms and is totally insignificant to Omega, representing less than 1% of Omega's purchases. (5 marks)

Query Two

The notes to the financial statements say that plant and equipment is held under the 'cost model'. However, property which is owner occupied is revalued annually to fair value. Changes in fair value are sometimes reported in profit or loss but usually in 'other comprehensive income'. Also, the amount of depreciation charged on plant and equipment as a percentage of its carrying amount is much higher than for owner occupied property. Another note says that property we own but rent out to others is not depreciated at all but is revalued annually to fair value. Changes in value of these properties are always reported in profit or loss. I thought we had to be consistent in our treatment of items in the accounts. Please explain how all these treatments comply with relevant reporting standards. (7 marks)

Query Three

As you know, in the year to September 20X6 we spent considerable sums of money designing a new product. We spent the six months from October 20X5 to March 20X6 researching into the feasibility of the product. We charged these research costs to profit or loss. From April 20X6, we were confident that the product would be commercially successful and we fully committed ourselves to financing its future development. We spent most of the rest of the year developing the product, which we will begin to sell in the next few months. These development costs have been recognised as intangible assets in our statement of financial position. How can this be right when all these research and development costs are design costs? Please justify this with reference to relevant reporting standards. (5 marks)

Query Four

On reviewing our financial statements, I found a note giving information about the different segments of our business and also the disclosure of the earnings per share of our entity. Neither the segment note nor the earnings per share disclosure appears in the financial statements of entity X (see query 1 above). Even though entity X is unlisted, both entities report under full International Financial Reporting Standards so I do not understand how this difference can occur. Please explain this to me. (3 marks)

Required

Provide answers to the queries raised by the managing director.

Note. The mark allocation is shown against each of the four queries above.

(Total = 20 marks)

Answers

**DO NOT TURN THIS PAGE UNTIL YOU HAVE
COMPLETED THE MOCK EXAM**

A PLAN OF ATTACK

If this had been the real Diploma in International Financial Reporting exam and you had been told to turn over and begin, what would have been going through your mind?

Perhaps you're having a panic. You've spent most of your study time on groups and international financial reporting standards (because that's what your tutor/BPP Study Text told you to do), and you're really not sure that you know enough. The good news is that you can always get a solid start by tackling the consolidation question. So calm down. Spend the first few moments or so **looking at the exam**, and develop a **plan of attack**.

Looking through the exam

The exam consists of **four compulsory questions**.

- Question 1 requires preparation of a consolidated statement of financial position.
- Question 2 requires explanation of a number of different issues.
- Question 3 deals with financial assets.
- Question 4 deals with explaining accounting issues to a non-accountant.

Group accounting question

You should be well-rehearsed in group accounts questions from your practice and revision. As usual with this type of question:

- Lay out the pro formas and slot in the figures as you calculate them.
- Write out workings as neatly as possible and cross-reference them to the statements.
- Save time by putting simple calculations on the face of the statements, rather than using a working.

Don't be tempted to go over time on this question. Remember that the 40-mark question should take you 78 minutes (including reading time). You will get most of your marks early on, so don't spend extra time looking for the errors or dealing with adjustments you are not sure of – go for the quick and easy marks in the time available.

Allocating your time

BPP's advice is always allocate your time according to the marks for the question in total and for the parts of the question. But always **use common sense**.

Forget about it!

And don't worry if you found the exam difficult. More than likely other candidates will too. The main thing is to keep your cool and be confident about what you know. And if this was the real exam, the only thing left to do is celebrate that it's over!

Question 1

Top tips. The group accounting question is always a tough one, covering a number of different topics, and with a lot of adjustments to keep track of. This can be off-putting when you first read the question, so make sure you have a plan to get started. The first thing to do is to set up your proforma for the statement of financial position. Then work through the adjustments in the order they appear in the question. Reference your calculations and show your workings clearly. This is for your benefit as well as for the marker. You will probably find that if you take each issue individually, you know how to deal with each one:

- Fair value adjustments to property and plant on acquisition of Beta and of Gamma
- Deferred tax on fair value adjustments
- Contingent liability unrecognised by Beta on acquisition
- Impairment of goodwill of Beta, where the NCI was measured using the proportion of net assets method
- Contingent consideration on acquisition of Gamma
- Intra-group transactions
- Provision for restoration of land

Easy marks. As usual, there are easy marks for slotting the simpler figures into the statement, or for some simple addition.

Examining team's comments. On the whole, this question was answered satisfactorily. Candidates know that Question 1 will always be a consolidation question and so understandably study the topic thoroughly.

More particularly, most candidates performed well in the following areas:

- General consolidation procedures – aggregation, elimination of pre-acquisition profits and the computation of non-controlling interests.
- The calculation of the fair value adjustments required due to the acquisitions of Beta and Gamma.
- The calculation of goodwill and (in the case of Beta) related impairment. It was pleasing to note that a majority of candidates realised that the goodwill of Beta had to be grossed up in the impairment review calculation since the non-controlling interest in Beta was initially measured using the proportion of net assets method.
- The elimination of intra-group balances and the treatment of reconciling items. Having said this, a significant minority of candidates incorrectly 'eliminated' the cash in transit by deducting it from consolidated trade payables rather than adding to cash and cash equivalents.

Areas that were not done as well in some cases were as follows:

- A number of candidates misread the information relating to the acquisition of Beta and assumed that the share exchange to effect the acquisition had not been accounted for by Alpha.
- A majority of candidates did not realise that the change in the fair value of contingent consideration since the date of acquisition should lead to an adjustment to consolidated retained earnings.
- Many candidates treated the contingent liability of the subsidiary at the date of acquisition, failing to recognise that this liability should be recognised at its fair value in the consolidated financial statements.
- Whilst most candidates were able to make a reasonable attempt to compute the restoration provision that was initially necessary at the start of the year, many candidates were not able to correctly account for the subsequent impact on property, plant and equipment (in terms of capitalisation and additional depreciation) and on the closing provision (in terms of the unwinding of the discount).

Marking scheme

Marks

CONSOLIDATED STATEMENT OF FINANCIAL POSITION OF ALPHA AT 30 SEPTEMBER 20X6

\$'000

Assets

Non-current assets

Property, plant and equipment (524,000 + 370,000 + 162,000) + [(40,000 (W1) – 3,000 (W1)) + (20,000 (W1) – 15,000 (W1)) + 20,000 (W2) + (7,800 – 390) (W8)]	1,125,410	½ + 1½ + ½
Goodwill (W3)	72,120	13 (W3)
	<u>1,197,530</u>	

Current assets

Inventories (120,000 + 75,000 + 60,000)	255,000	½
Trade receivables (90,000 + 66,000 + 55,000 – 10,000 (intra-group))	201,000	½ + ½
Cash and cash equivalents (15,000 + 12,000 + 10,000 + 10,000 (cash in transit))	47,000	½ + ½
	<u>503,000</u>	
	<u>1,700,530</u>	

Total assets

Equity and liabilities

Equity attributable to equity holders of the parent

Share capital	140,000	½
Retained earnings (W6)	613,642	13 (W6)
Other components of equity (W7)	254,000	1 (W7)
	<u>1,007,642</u>	
Non-controlling interest (W5)	120,470	2 (W5)
	<u>1,128,112</u>	

Total equity

Non-current liabilities

Provision (7,800 + 468 (W8))	8,268	½ + ½
Long-term borrowings (82,750 + 90,000 + 48,000)	220,750	½
Deferred consideration (20,000 + 4,000)	24,000	½ + ½
Deferred tax (W9)	115,400	1½ (W9)
	<u>368,418</u>	

Total non-current liabilities

Current liabilities

Trade and other payables (60,000 + 50,000 + 30,000)	140,000	½ + ½
Short-term borrowings (20,000 + 35,000 + 9,000)	64,000	½
	<u>204,000</u>	<u>40</u>

Total current liabilities

Total equity and liabilities

1,700,530



Workings – Do not double count marks. All numbers in \$'000 unless otherwise stated

1 Net assets table – Beta

	1 October 20X3 \$'000	30 September 20X6 \$'000	For W3	For W6
Share capital	100,000	100,000	½	
Retained earnings:				
Per accounts of Beta	150,000	210,000	½	½
Fair value adjustments:				
Property (200,000 – 160,000)	40,000	40,000	½	½
Extra depreciation due to buildings uplift ((120,000 – 90,000) × 3/30)		(3,000)		½
Plant and equipment (140,000 – 120,000)	20,000	20,000	½	½
Extra depreciation due to plant and equipment uplift (20,000 × ¾)		(15,000)		½
Contingent liability	(6,000)	Nil	½	½
Other components of equity	5,000	10,000	½	½
Deferred tax on fair value adjustments:				
Date of acquisition (20% × 54,000 (see above))	(10,800)		½	
Year end (20% × 42,000 (see above))		(8,400)		½
Net assets for the consolidation	<u>298,200</u>	<u>353,600</u>		
The post-acquisition increase in net assets is 55,400 (298,200 – 353,600). 5,000 of this increase is due to changes in other components of equity and the remaining 50,400 to changes in retained earnings.				½
			<u>3½</u>	<u>5</u>
			⇒ W3	⇒ W6

2 Net assets table – Gamma

	1 October 20X3 \$'000	30 September 20X6 \$'000	For W3	For W6
Share capital	80,000	80,000	½	
Retained earnings:	75,000	90,000	½	½
Land adjustment (70,000 – 50,000)	20,000	20,000	½	½
Deferred tax on fair value adjustment (20% × 20,000)	(4,000)	(4,000)	½	½
Net assets for the consolidation	<u>171,000</u>	<u>186,000</u>		
The post-acquisition increase in net assets is 15,000 (186,000 – 171,000).				½
			<u>2</u>	<u>2</u>
			⇒ W3	⇒ W6



				Marks
3	Goodwill on consolidation			
		Beta	Gamma	
		\$'000	\$'000	
	Costs of investment:			
	Shares issued to acquire Beta ($40,000 \times \$7.00$)	280,000		1
	Cash paid to acquire shares in Gamma		140,000	½
	Contingent consideration re: Gamma acquisition		20,000	1
	Non-controlling interests at date of acquisition:			
	Beta – $20\% \times 298,200$ (W1)	59,640		1
	Gamma – $20,000 \times \$2.30$		46,000	1
	Net assets at date of acquisition (W1/W2)	(298,200)	(171,000)	3½ (W1) + 2 (W2))
	Goodwill before impairment	41,440	35,000	
	Impairment of Beta goodwill (W4)	(4,320)	Nil	3 (W4)
		<u>37,120</u>	<u>35,000</u>	<u>13</u>
	The total goodwill is 72,120 (37,120 + 35,000).			
4	Impairment of Beta goodwill			
			\$'000	
	Net assets of Beta as per Working 1		353,600	½
	Grossed up goodwill on acquisition ($100/80 \times 41,440$)		51,800	1
			<u>405,400</u>	
	Recoverable amount of Beta as a CGU		(400,000)	½
	So gross impairment equals		5,400	½
	80% thereof equals		<u>4,320</u>	½
			<u>3</u>	<u>3</u>
				⇒W3
5	Non-controlling interest			
		Beta	Gamma	
		\$'000	\$'000	
	At date of acquisition (W3)	59,640	46,000	½ + ½
	Share of post-acquisition increase in net assets per Workings 1 and 2:			
	Beta – $20\% \times 55,400$ (W1)	11,080		½
	Gamma – $25\% \times 15,000$ (W2)		3,750	½
		<u>70,720</u>	<u>49,750</u>	<u>2</u>
	The total NCI is 120,470 (70,720 + 49,750).			
6	Retained earnings			
			\$'000	
	Alpha		573,000	½
	Adjustment for acquisition costs		(3,000)	½
	Adjustment for increase in contingent consideration re: Gamma (24,000 – 20,000)		(4,000)	½
	Adjustment for restoration provision (W8)		392	3 (W8)
	Beta ($80\% \times 50,400$ (W1))		40,320	½ + 5 (W1)
	Gamma ($75\% \times (15,000$ (W2))		11,250	½ + 2 (W2)
	Impairment of Beta goodwill (W4)		(4,320)	½
			<u>613,642</u>	<u>13</u>

			Marks
7	<i>Other components of equity</i>		
		\$'000	
	Alpha – per own financial statements	250,000	½
	Beta ($80\% \times 5,000$ (W1))	<u>4,000</u>	½
		<u>254,000</u>	<u>1</u>
8	<i>Adjustment re: restoration provision</i>		
		\$'000	
	Originally required provision ($25,000 \times 0.312$)	<u>7,800</u>	1
	One year's unwinding of discount ($7,800 \times 6\%$)	(468)	½
	One year's depreciation of capitalised cost ($7,800 \times 1/20$)	(390)	1
	Original provision incorrectly made	<u>1,250</u>	½
	So retained earnings adjustment equals	<u>392</u>	<u>3</u>
			⇒ W6
9	<i>Deferred tax</i>		
		\$'000	
	Alpha + Beta + Gamma	103,000	½
	On fair value adjustments in Beta (W1)	8,400	½
	On fair value adjustments in Gamma (W2)	<u>4,000</u>	½
		<u>115,400</u>	<u>1½</u>

Question 2

Top tips. This is another typical question requiring you to explain three different issues. Part (a) required you to recognise and account for a finance lease in the books of the lessor. Note that IFRS 16 *Leases* retains the distinction between finance and operating leases for lessors, though not for lessees. Part (b) required you to account the sale of a product to an overseas customer where the customer had a right to return the product within a specified period. Part (c) required you to account for a cash settled share-based payment. Note that this topic appears in almost every exam.

Easy marks. As usual in this type of question, there were easy marks available for stating the main principles in the relevant standards. Don't forget that you have to **explain** the accounting treatment in order to get a good mark.

Examining team's comments. In part (a), the majority of candidates realised that the lease was a finance lease. However, many candidates did not seem to realise that this involved the lessor recognising a financial asset rather than an investment property (or property, plant and equipment). A large number of candidates incorrectly stated that Delta would depreciate the asset and recognise rental income in profit or loss. This is of course the treatment that would have been appropriate had the lease been an operating lease. A significant minority of candidates answered this question as if Delta were the lessee, rather than the lessor.

In part (b) most candidates were able to correctly quote relevant sections from IFRS 15 *Revenue from Contracts with Customers* regarding the recognition of revenue. However a significant number of candidates were unable to correctly compute the refund liability that should have been provided for. Common errors here included applying IAS 37 *Provisions, Contingent Assets and Contingent Liabilities* rather than IFRS 15. This often led to the incorrect conclusion that the refund liability was contingent and should be disclosed, rather than recognised. Even where the need to compute a refund liability was recognised, many candidates incorrectly used 22% rather than 8%, on the (incorrect) basis that the estimate made on 15 October 20X6 was a non-adjusting event after the reporting date. It was pleasing to note, though, that most candidates were able to gain some marks in this part by correctly applying the requirements of IAS 21 *Foreign Currency Transactions* to this scenario.

Part (c) was generally answered quite well – almost all candidates had the basic idea that the cost should be taken to profit or loss over the vesting period based on the expected number of options vesting. However a minority of candidates appeared unclear of the differences between cash and equity settled share-based payments. Common errors included using the fair value at the grant date throughout (that would have been appropriate had this been an equity settled scheme) and presenting the credit entry in equity rather than liabilities (again, this would have been correct had the scheme been equity, rather than cash settled).

[References: IFRS 2: paras. 33–33D; IFRS 15: paras. 9, 51, B20–B27; IFRS 16: paras. 61–80]

Marking Scheme

Marks

(a) All numbers in \$'000 unless otherwise stated

The lease of the asset by Delta to Epsilon would be regarded as a **finance lease** in Delta's financial statements because the **risks and rewards of ownership** have been transferred to Epsilon. (Delta is the lessor, and so the distinction between finance and operating leases still applies under IFRS 16 *Leases*.) Evidence of this includes **the lease is for the whole of the life of the asset** and Epsilon being responsible for repairs and maintenance.

$\frac{1}{2} + \frac{1}{2} + \frac{1}{2}$

Since the lease is a finance lease and Delta is the lessor, Delta will recognise a **financial asset – the 'net investment in finance leases'**. The amount recognised will be the present value of the minimum lease payments which will be **\$2,787 × 7.247 which (subject to rounding) equals \$20,200**.

$\frac{1}{2} + 1$



Note. This mark can also be awarded if candidates state that the initially recognised amount is the purchase cost of the asset plus the initial direct costs.

The impact of the lease on the financial statements for the year ended 30 September 20X6 can best be seen by preparing a profile of the net investment in the lease for the first three years of the lease and shown below:

<i>Year to</i>	<i>Balance</i>		<i>Balance</i>	<i>Finance</i>	<i>Balance</i>	
<i>30 September</i>	<i>b/fwd</i>	<i>Rental</i>	<i>in period</i>	<i>income</i>	<i>c/fwd</i>	
20X5	20,200	(2,787)	17,413	1,393	18,806	1½
20X6	18,806	(2,787)	16,019	1,282	17,301	1
20X7	17,301	(2,787)	14,514			½

During the year ended 30 September 20X6, Delta will recognise income from finance leases of \$1,282. ½

The net investment on 30 September 20X6 will be \$17,301. ½

Of the closing net investment of \$17,301, \$2,787 will be shown as a current asset and \$14,514 as a non-current asset. ½ + ½
8

- (b) When the customer has a right to return products, the transaction price contains a **variable element**. When this element can be **reliably measured**, it is taken account of in measuring the revenue. ½ + ½

The information regarding the change in likelihood of return after 30 September 20X6 is an **adjusting event** as it gives more information about conditions existing at the reporting date. ½

Therefore the revenue in florins for the year ended 30 September 20X6 will be **460,000** (500,000 × 92%). ½

This will be recognised in the financial statements of Delta using the rate of exchange in force at the date of the transaction (2 florins to \$1). Therefore revenue of **\$230,000** will be recognised. ½

Delta will initially recognise a trade receivable of **500,000 florins**. This will be initially recognised in \$ as \$250,000. At the year end, the trade receivable will be re-translated using the closing rate of 2.1 florins to \$1 because it is a monetary item. The closing trade receivable will be **\$238,095** (500,000/2.1). ½ + ½

The loss on re-translation of the trade receivable of **\$11,905** (\$250,000 – \$238,095) will be recognised in **profit or loss**. ½ + ½

The difference (in florins) of 40,000 between the revenue recognised (460,000) and the trade receivable (500,000) will be recognised as a **refund liability**. This liability will initially be included in the financial statements at **\$20,000** (40,000/2). ½ + ½

The refund liability is monetary so it will be re-translated to **\$19,048** (40,000/2.1). ½

The gain on re-translation of **\$952** (\$20,000 – \$19,048) will be recognised in **profit or loss**. ½ + ½
7

	Marks
(c) In accordance with IFRS 2 <i>Share-based Payments</i> this cash-settled share-based payment arrangement should be measured using the fair value of an option on the reporting date , with a debit to profit or loss and a corresponding credit to liabilities .	$\frac{1}{2} + \frac{1}{2}$
The liability should be built up over the vesting period based on the estimated number of rights ultimately estimated to vest .	$\frac{1}{2} + \frac{1}{2}$
The liability at 30 September 20X5 would have been \$26,250 [$\frac{1}{3} (250 \times 90 \times \$3.50)$].	1
The liability at 30 September 20X6 would have increased to \$52,800 [$\frac{2}{3} (250 \times 88 \times \$3.60)$]. This will be shown as a non-current liability.	1
The increase in the liability over the year of \$26,550 (\$52,800 – \$26,250) will be shown as an expense in profit or loss for the year ended 30 September 20X6.	<u>1</u>
	<u>5</u>
	<u>20</u>

Question 3

Top tips. This question was on financial instruments, specifically financial assets. Part (a) required explanation from IFRS 9 of how financial assets are classified and measured. Part (b) required application of the IFRS 9 rules to three transactions. Bear in mind that you need to discuss the treatment and not just show the accounting entries. And while you may not have come across the specific treatment of interest-free loans before, you can apply the principles of IFRS 9 (what is fair value in this case?) and the *Conceptual Framework*.

Easy marks. These are available in part (a) for the discussion of the requirements of IFRS 9 in relation to financial assets.

Examining team's comments. Answers to part (a) were mixed. Most candidates were able to identify that there were three different measurement bases for financial assets dependent on the nature of the cash flows and the business model. However only a minority of candidates were able to correctly describe when each measurement basis would be appropriate. A minority of candidates mistakenly thought they were being asked to describe the requirements of IFRS 13 *Fair Value Measurement*. This was not asked for and did not attract marks. Other candidates wasted time by referring to the measurement of financial liabilities and equity instruments – the question was clearly focused on financial assets. Still other candidates made out of date references to the classifications used in IAS 39 – the predecessor standard. A popular reference in this regard was to 'available for sale' assets.

Most candidates realised that the loan to the employee (part b(i)) was a financial asset that should be measured at amortised cost. However only about half the candidates realised that the initial carrying amount of the asset (on which the subsequent amortised cost measurement was based) would be the fair value of the loan at its inception (involving discounting).

Answers to part (b)(ii) were generally rather disappointing. Few candidates appreciated that the three year loan to company X failed the 'contractual cash flow test', meaning that the loan asset would be classified as fair value through profit or loss. A minority of candidates attempted to compute a 'split presentation' of the financial instrument along the lines of a convertible loan treated as part liability and part equity. All in all, answers to this part were unsatisfactory.

Answers to part (b)(iii) were generally satisfactory. Almost all candidates appreciated that equity investments had to be measured at fair value. However only some candidates mentioned the need to make an election should Kappa wish to measure the asset at fair value through other comprehensive income.

[References: IFRS 9: paras. 4.1.2–4.1.5, 5.1.1, Appendix A]

Marking scheme

	Marks
(a) The classification and measurement of financial assets is largely based on:	
The business model for managing the asset – specifically whether or not the objective is to hold the financial asset in order to collect the contractual cash flows.	1
Whether or not the contractual cash flows are solely payments of principal and interest on the principal amount outstanding.	1
Where the business model for managing the asset is to hold the financial asset in order to collect the contractual cash flows and the contractual cash flows are solely payments of principal and interest on the principal amount outstanding, then the financial asset is normally measured at amortised cost.	1



	Marks
Where the business model for managing the asset is to both hold the financial asset in order to collect the contractual cash flows and to sell the financial asset and the contractual cash flows are solely payments of principal and interest on the principal amount outstanding, then the financial asset is normally measured at fair value through other comprehensive income. Interest income on such assets is recognised in the same way as if the asset were measured at amortised cost.	1 + 1
In other circumstances, financial assets are normally measured at fair value through profit or loss.	1
Notwithstanding the above, where equity investments are not held for trading, an entity may make an irrevocable election to measure such investments at fair value through other comprehensive income.	1
Finally an entity may, at initial recognition, irrevocably designate a financial asset as measured at fair value through profit or loss if to do so eliminates or significantly reduces an accounting mismatch.	<u>1</u> 8
(b) (i) The loan is a financial asset which would initially be recognised at its fair value on 1 October 20X5.	½
Given the fact that Kappa normally requires a return of 10% per annum on business loans of this type, the loan asset should be initially recognised at \$661,157 (\$800,000/(1.10) ²).	1
An amount of \$138,843 (\$800,000 – \$661,157) would be charged to profit or loss at 1 October 20X5.	1
Because of the business model and the contractual cash flows, this loan asset will subsequently be measured at amortised cost.	1
Therefore \$66,116 (\$661,157 × 10%) will be recognised as finance income in the year ended 30 September 20X6. The closing loan asset \$727,273 will be (\$661,157 + \$66,116). This will be shown as a current asset since repayment is due on 30 September 20X7.	$\frac{1}{2} + \frac{1}{2}$ <u>+ ½</u> 5
(ii) Since the loan is at normal commercial rates, the loan would initially be recognised at \$10 million – the amount advanced.	½
The interest received and receivable of \$800,000 would be credited to profit or loss as finance income.	1
In this case, the contractual cash flows are not solely payments of principal and interest on the principal amount outstanding. Therefore the asset would be measured at fair value through profit or loss.	1
A fair value gain of \$500,000 (\$10.5 million – \$10 million) would be recognised in profit or loss.	1
The loan asset of \$10.5 million would be shown as a non-current asset.	$\frac{1}{2}$ <u>4</u>



- (iii) The equity investment would be initially recognised at its cost of purchase – \$12 million.

1

The contractual cash flows relating to an equity investment are not solely payments of principal and interest on the principal amount outstanding. Therefore the asset would normally be measured at fair value through profit or loss. This would result in a gain on remeasurement to fair value of \$1 million (\$13 million – \$12 million) being recognised in profit or loss.

1

Since the equity investment is being held for the long term, rather than as part of a trading portfolio, it is possible to make an irrevocable election on 1 October 20X5 to classify the asset as fair value through other comprehensive income. In such circumstances, the remeasurement gain of \$1 million would be recognised in other comprehensive income rather than profit or loss.

1
3
20

Question 4

Top tips. This was a typical discursive question, requiring you to explain four different issues to a non-accountant. Part (a) concerned related parties. The managing director owning 100% of the shares of entity X should have flagged this to you.

Part (b) considered the treatment of tangible non-current assets. In order to score full marks on this section, you needed to cover investment properties as well as property, plant and equipment. This should have been apparent when the question mentioned 'property we own but rent out to others'.

Part (c) considered the accounting treatment of research and development expenditure.

Part (d) focused on the difference between listed and unlisted entities reporting under IFRS. This may have confused you at first as you may have thought that the question was asking about the IFRS for SMEs – it wasn't. What was required was knowledge that some IFRSs are **only** applicable to listed companies.

Easy marks. You should have been able to score almost full marks on parts (b) and (c) as these were both relatively straightforward.

Examining team's comments. In part (a) most candidates realised that entity X was a related party to Omega. However only few fully explained exactly why this was so, and that related party transactions are material by their nature rather than on the basis of their size. A few candidates made the erroneous statement that entity X was a subsidiary of Omega and should be consolidated by Omega.

Parts (b) and (c) were generally answered satisfactorily, with a pleasing level of knowledge being displayed by the majority of candidates. Answers to part (d) were more variable. Whilst some candidates scored good marks here, others wasted time by referring to the *IFRS for SMEs* when the question made it clear that entity X reported under full IFRS. Other candidates referred specifically to the reporting requirements of IFRS 8 *Operating Segments*, and IAS 33 *Earnings per Share*. Even where such references were accurate, no marks could be awarded since this was not what the question was asking.

[References: IAS 16: paras. 11, 12, 15–62A; IAS 24: paras. 9, 13–19; IAS 38: paras. 51–64]

Marking scheme

	Marks
Query One	
The reason disclosure of this transaction is necessary is because entity X is a related party of Omega. Related parties are generally characterised by the presence of control or influence between the two parties.	½ + ½
IAS 24 <i>Related Party Disclosures</i> identifies related parties as, inter alia, key management personnel and companies controlled by key management personnel . On this basis, entity X is a related party of Omega.	½ + ½
Where related party relationships exist, IAS 24 requires the disclosure of the existence of the relationship where the related party controls the reporting entity. This is not the case here, so in the absence of transactions disclosure would not be required.	1
Where transactions occur with related parties, IAS 24 requires that details of the transactions are disclosed in a note to the financial statements. This is required even if the transactions are carried out on a normal arm's length basis.	1
Transactions with related parties are material by their nature, so the fact that the transaction may be numerically insignificant to Omega does not affect the need for disclosure.	<u>1</u> <u>5</u>

Query Two

The accounting treatment of the majority of tangible non-current assets is governed by IAS 16 <i>Property, Plant and Equipment</i> (PPE).	½
IAS 16 states that the accounting treatment of PPE is determined on a class by class basis. For this purpose, property and plant would be regarded as separate classes.	1
IAS 16 requires that PPE is measured using either the cost model or the revaluation model. This model is applied on a class by class basis and must be applied consistently within a class.	1
IAS 16 states that when the revaluation model applies, surpluses are recorded in other comprehensive income, unless they are cancelling out a deficit which has previously been reported in profit or loss, in which case it is reported in profit or loss.	1
Where the revaluation results in a deficit, then such deficits are reported in profit or loss, unless they are cancelling out a surplus which has previously been reported in other comprehensive income, in which case they are reported in other comprehensive income.	½
According to IAS 16, all assets having a finite useful life should be depreciated over that life. Where property is concerned, the only depreciable element of the property is the buildings element, since land normally has an indefinite life. The estimated useful life of a building tends to be much longer than for plant. These two reasons together explain why the depreciation charge of a property as a percentage of its carrying amount tends to be much lower than for plant.	½ + ½ + ½
Properties which are held for investment purposes are not accounted for under IAS 16, but under IAS 40 <i>Investment Property</i> .	½
Under the principles of IAS 40, investment properties can be accounted for under a cost or a fair value model. We apply the fair value model and thus our investment properties are revalued annually to fair value, with any changes being reported in profit or loss.	<u>1</u> <u>7</u>

Query Three

Accounting for product design costs is governed by IAS 38 <i>Intangible Assets</i> .	½
Under IAS 38, the treatment of expenditure on intangible items depends on how it arose.	½
Generally internal expenditure on intangible items cannot be recognised as assets.	1
The exception to the above rule is that once it can be demonstrated that a development project is likely to be technically feasible, commercially viable, overall profitable and can be adequately resourced , then future expenditure on the project can be recognised as an intangible asset. This explains the differing treatment of expenditure up to 31 March 20X6 and expenditure after that date.	½ + ½ + ½ <u>½ + ½ + ½</u> <u>5</u>

Query Four

Where two companies report under the same reporting framework, you would generally expect the same reporting requirements to apply to both companies. However, there are certain requirements of IFRS which apply to listed companies only .	½ + ½
The requirement to provide segmental information and to disclose earnings per share are both examples of requirements which only listed companies are forced to comply with.	1
If an unlisted entity voluntarily chooses to provide segmental information, or to disclose its earnings per share, then it must comply with the provisions of the relevant IFRS in both cases.	<u>1</u> <u>3</u> <u>20</u>

ACCA Diploma in International Financial Reporting BPP Mock Exam 2 (June 2017 exam)

Questions	
Time allowed	3 hours and 15 minutes
ALL FOUR questions are COMPULSORY and must be attempted	

Do NOT open this exam until instructed by the supervisor.

This exam must not be removed from the examination hall.

ALL FOUR questions are compulsory and MUST be attempted

Question 1

Alpha holds investments in a number of entities, including Beta and Gamma. The statements of profit or loss and other comprehensive income and summarised statements of changes in equity of the three entities for the year ended 31 March 20X7 were as follows:

STATEMENTS OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME

	<i>Alpha</i>	<i>Beta</i>	<i>Gamma</i>
	\$'000	\$'000	\$'000
Revenue (Note 3)	468,000	260,000	240,000
Cost of sales (Notes 1-3)	(312,000)	(135,000)	(120,000)
Gross profit	156,000	125,000	120,000
Distribution costs	(26,000)	(20,000)	(18,000)
Administrative expenses (Note 4)	(44,000)	(28,000)	(27,000)
Investment income (Note 5)	28,000	Nil	Nil
Finance costs	(20,000)	(22,000)	(21,000)
Profit before tax	94,000	55,000	54,000
Income tax expense	(24,000)	(14,000)	13,500
Profit for the year	70,000	41,000	40,500

Other comprehensive income:

Items that will be reclassified to profit or loss

	Nil	Nil	Nil
Gains/(losses) on effective cash-flow hedges (Note 6)	70,000	41,000	40,500
<i>Total comprehensive income</i>			

Summarised statements of changes in equity

Balance on 1 April 20X6	250,000	193,000	166,500
Comprehensive income for the year	70,000	41,000	40,500
Dividends paid on 31 December 20X6	(40,000)	(18,000)	(16,000)
<i>Balance on 31 March 20X7</i>	<i>280,000</i>	<i>216,000</i>	<i>191,000</i>

Note 1 – Alpha's investment in Beta

On 1 April 20W1, Alpha acquired 80 million of the 100 million \$1 equity shares of Beta and gained control of Beta. Alpha paid \$150 million in cash for these shares.

On 1 April 20W1, the net assets of Beta had a fair value of \$147 million, all of which had been disposed of or settled by 31 March 20X6.

Alpha used the fair value method for measuring the non-controlling interest when recognising the goodwill on acquisition of Beta. The fair value of an equity share in Beta on 1 April 20W1, which was \$1.50, was used for this purpose. No impairments of goodwill on acquisition of Beta have been necessary in the consolidated financial statements of Alpha up to and including 31 March 20X6.

Beta has three cash generating units. On 31 March 20X7, the annual impairment review indicated that the recoverable amounts of the net assets, including goodwill, of the three cash generating units of Beta at that date were as follows:

- Unit 1 – \$87 million
- Unit 2 – \$84 million
- Unit 3 – \$80 million



Net assets and goodwill are allocated equally to the three units and any impairments of goodwill should be charged to cost of sales.

Note 2 – Alpha's investment in Gamma

On 1 August 20X6, Alpha acquired 60 million of the 80 million \$1 equity shares in Gamma and gained control of Gamma. The acquisition was financed as follows:

- Alpha issued two new shares to the former shareholders of Gamma for every three shares Alpha acquired in Gamma. On 1 August 20X6, the fair value of an equity share in Alpha was \$4.50.
- Alpha agreed to pay a total of \$16.2 million in cash to the former shareholders of Gamma on 31 July 20X7. Alpha's incremental borrowing rate at 1 August 20X6 was 8% per annum.
- Alpha agreed to issue additional shares in Alpha to the former shareholders of Gamma on 30 September 20X9 if the cumulative profits of Gamma for the three-year period from 1 August 20X6 to 31 July 20X9 exceed a target amount. On 1 August 20X6, the fair value of this contingent equity consideration was \$26 million.

Alpha has not yet accounted for this acquisition in its individual financial statements. However, you can assume that no impairment of the goodwill on acquisition of Gamma is necessary in the consolidated financial statements of Alpha for the year ended 31 March 20X7. Alpha has resolved to use the proportion of net assets method for measuring the non-controlling interest when recognising the goodwill on the acquisition of Gamma.

On 1 August 20X6, the fair values of the net assets of Gamma were the same as their carrying amounts in the financial statements of Gamma with the exception of:

- Land – whose fair value exceeded the carrying amount by \$30 million.
- Plant and equipment – whose fair value exceeded the carrying amount by \$12 million. The estimated remaining useful life of the plant and equipment of Gamma at 1 August 20X6 was five years.

All depreciation of property, plant and equipment is charged to cost of sales. You can assume that the profit of Gamma for the year ended 31 March 20X7 accrued evenly over the year.

Note 3 – Intra-group trading

Alpha supplies a component used by both Beta and Gamma. Alpha earns a profit margin of 20% on these supplies. Details of the sales of the component, and the holdings of inventory of the component by group entities, are as follows:

	Beta	Gamma
	\$'000	\$'000
Sales of the component (for Gamma all sales since 1 August 20X6)	20,000	10,000
Inventory of component at 31 March 20X6 (at cost to Beta/Gamma)	4,000	Nil
Inventory of component at 31 March 20X7 (at cost to Beta/Gamma)	6,000	4,800

Note 4 – Decommissioning provision

On 1 April 20X6, Alpha completed the construction of an energy generating facility and brought the facility into use immediately. The cost of construction of the facility was included in property, plant and equipment and was also appropriately depreciated over the useful life of the facility, which was estimated at 16 years at 1 April 20X6. At the end of the useful life of the facility, Alpha has an obligation to decommission the facility and restore its location to its former condition. The estimated cost of this decommissioning and restoration is \$8 million, payable on 31 March 2022. The directors of Alpha made a provision of \$8 million in respect of this liability, and charged \$8 million to administrative expenses in the year ended 31 March 20X7. An appropriate discount rate to use in any discounting calculations is 8% per annum. At 1 April 20X6, the present value of \$1 payable in 16 years' time at 8% can be taken as 30 cents.

Note 5 – Investment income

The investment income which is shown in Alpha's statement of profit or loss represents dividends received from Beta and Gamma and also dividends received from a portfolio of other equity investments. This portfolio is classified by Alpha as fair value through profit or loss. The gain on remeasurement of the portfolio to fair value at 31 March 20X7 was \$6.5 million. This gain has not yet been recognised in the financial statements of Alpha.

Note 6 – Cash flow hedge

On 1 January 20X7, Alpha agreed to purchase goods from a foreign supplier. This purchase is due to be made and paid for on 30 June 20X7. The directors of Alpha decided to hedge the cash-flow risk attaching to this future purchase by entering into a derivative contract and to formally designate the derivative as a hedging instrument. The hedge met all of the effectiveness requirements for the use of hedge accounting. On 31 March 20X7, the derivative had a positive fair value resulting in a gain to Alpha of \$5 million. Between 1 January 20X7 and 31 March 20X7 the expected cash flows in respect of the purchase of goods on 30 June 20X7 had increased by \$4.2 million. Alpha has not made any accounting entries in respect of this arrangement.

Required

- (a) Using the information in notes 1 and 2, compute the goodwill arising on the acquisitions of Beta and Gamma in the consolidated financial statements of Alpha. (7 marks)
- (b) Prepare the consolidated statement of profit or loss and other comprehensive income of Alpha for the year ended at 31 March 20X7. You do not need to consider the tax effects of any adjustments you make. (26 marks)
- (c) Prepare the summarised consolidated statement of changes in equity of Alpha for the year ended 31 March 20X7, including a column for the non-controlling interest. (7 marks)

Note. You should show all workings to the nearest \$'000.

(Total = 40 marks)

Question 2

Delta is an entity which prepares financial statements to 31 March each year. Each year, the financial statements are authorised for issue on 25 May. The following events have occurred which are relevant to the year ended 31 March 20X7:

Event (a)

On 1 April 20X6, Delta purchased an asset for \$771,000 and immediately leased this asset to entity X. The lease term was for five years and the lease rental, receivable annually in arrears on 31 March, was \$200,000. Delta incurred direct costs of \$20,000 in arranging this lease. The annual rate of interest implicit in this lease was 10%. Under the terms of the lease, entity X is responsible for insuring the asset and for carrying out any necessary repairs and maintenance of the asset. At a discount rate of 10% per annum the present value of \$1 receivable annually in arrears for five years is \$3.80.

(8 marks)

Event (b)

On 1 April 20X6, Delta entered into a joint arrangement with entity Y to jointly operate a delivery depot. Entity Y is located, and has major customers in, the same geographical region as Delta. Delta and entity Y each made the following payments in respect of the arrangement on 1 April 20X6:

- \$25 million each to purchase a joint 25-year leasehold interest in a depot which was close to both Delta and entity Y's business premises. This depot was to act as headquarters for the delivery vehicles (see below).
- \$7.5 million each to purchase a fleet of delivery vehicles. The vehicles have an expected useful life of five years, with no expected residual value.

Delta and entity Y agreed to jointly use the delivery vehicles to deliver products to their customers, and to share the operating costs of the depot equally. Any delivery charges to customers were levied by Delta and entity Y directly at the discretion of the individual entities. During the year ended 31 March 20X7, the total cash cost of operating the depot was \$8 million. This was paid equally by Delta and entity Y. In the year ended 31 March 20X7, Delta charged its customers a total of \$2 million in delivery charges.

(7 marks)

Event (c)

On 31 March 20X7, Delta was owed \$10m by entity Z. The amount was due for payment by 30 April 20X7. Entity Z has been a customer for many years and has an excellent payment record. At 31 March 20X7, there was no reason to suppose that entity Z would fail to pay the \$10m owed to Delta by 30 April 20X7. By 20 April 20X7, entity Z's going concern status was in considerable doubt.

(5 marks)

Required

Explain and state (where possible by quantifying amounts) how the three events would be reported in the financial statements of Delta for the year ended 31 March 20X7.

Note. The mark allocation is shown against each of the three events above. You should assume that all amounts described here are material.

(Total = 20 marks)

Question 3

- (a) Non-current assets are often a highly significant component of the total assets of an entity. Therefore, a number of different International Financial Reporting Standards have been published which regulate their definition, recognition, measurement and disclosure. IAS 1 *Presentation of Financial Statements* distinguishes between current and non-current assets. IAS 16 *Property, Plant and Equipment* and IAS 38 *Intangible Assets* specifically regulate the recognition, measurement and disclosure of tangible and intangible assets respectively.

Required

Explain how:

- (i) IAS 1 distinguishes between current and non-current assets. (3 marks)
 (ii) IAS 16 defines property, plant and equipment and IAS 38 defines intangible assets. (4 marks)
- (b) Epsilon prepares financial statements to 31 March each year. The following events have occurred which are relevant to the year ended 31 March 20X7:

- (i) On 1 April 20X6, Epsilon purchased a new head office property for \$60 million. On 1 April 20X6, Epsilon leased out the top three floors of the property to a third party on a long-term operating lease. The annual rental receivable by Epsilon was \$2 million, starting on 31 March 20X7. The top three floors of the property were capable of being sold in a separate transaction. On 1 April 20X6, the directors of Epsilon estimated that the initial cost of the property should be allocated as follows for accounting purposes:

	\$ million
Top three floors of building	15
Remainder – buildings component	20
Remainder – land component	25
Total initial cost	60

On 31 March 20X7, the property had an estimated total fair value of \$64 million. The directors consider that 25% of this fair value was attributable to the top three floors of the property. The directors of Epsilon wish to use the cost model for measuring property, plant and equipment and the fair value model for measuring investment property. Epsilon depreciates the buildings component of properties over an estimated useful life of 50 years, with no estimated residual value. The rental payable to Epsilon on 31 March 20X7 was paid in accordance with the terms of the lease. (8 marks)

- (ii) On 1 April 20X6, Epsilon purchased a brand from a competitor for an agreed price of \$80 million. The directors of Epsilon believe that the useful life of the brand is indefinite. On 31 March 20X7, no reliable estimate of its selling price was available but the directors of Epsilon estimated that the value in use of the brand was \$85 million. The directors of Epsilon wish to use the fair value model for measuring intangible assets whenever permitted by International Financial Reporting Standards.

(5 marks)

Required

Explain and state how the two events should be reported in the financial statements of Epsilon for the year ended 31 March 20X7.

Note. The mark allocation is shown against each of the two events above.

(Total = 20 marks)



Question 4

You are the financial controller of Omega, a listed entity which prepares consolidated financial statements in accordance with International Financial Reporting Standards (IFRS). One of your assistants, a trainee accountant, is involved in the preparation of the consolidated financial statements for the year ended 31 March 20X7. She is also involved in the preparation of the individual financial statements for the entities in the group. She has sent you an email with the following queries:

Query One

On 1 April 20X6 we acquired a new subsidiary. This subsidiary has always prepared its financial statements in \$ but has used IFRS for the first time this year. Previously, they have used local standards. This means that the comparative figures (they present comparatives for one year only), taken from last year's financial statements, will be based on local standards not IFRS. How do I make sure we are comparing like with like in the current year individual financial statements of the subsidiary? Please just give me the general procedure, rather than dealing with any specialised exemptions. (7 marks)

Query Two

I notice that on 1 April 20X6 we lent \$50 million to a key supplier. The loan has an annual rate of interest of 5%, with interest of \$2.5 million payable on 31 March each year in arrears. The loan is repayable on 31 March 2026 but I believe that if interest rates change, we might consider assigning the loan to a third party. As it turns out, interest rates have fallen since 1 April 20X6 and the fair value of the loan asset at 31 March 20X7 was \$52 million. I have been told that this loan asset should be measured at 'fair value through other comprehensive income'. Why is this? I thought loan assets were measured at amortised cost. If the loan asset is measured at fair value through other comprehensive income, does the interest income get recorded in other comprehensive income rather than profit or loss? (6 marks)

Query Three

I'm not sure whether we need to make any entries in respect of the equity settled share-based payment scheme we started on 1 April 20X6. I believe we granted options to 1,000 employees to purchase 100 shares in Omega for a fixed price. The options vest on 31 March 20Y1 subject to two conditions. The first vesting condition is that the employees remain employed by Omega throughout the five-year period up to the date of vesting. Best estimates are that 900 of the 1,000 will stay for that period – only 25 left in the year ended 31 March 20X7. The other condition is that the Omega share price on 31 March 20Y1 should be at least \$10. The share price on 31 March 20X7 was only \$8.50 so it doesn't look like this condition is satisfied yet. I've also noticed that the fair value of one share option was \$1 on 1 April 20X6, rising to \$1.05 on 31 March 20X7. Do we need any accounting entries and, if so, what should they be? (7 marks)

Required

Provide answers to the three queries raised by the trainee accountant. Your answers should refer to relevant provisions of International Financial Reporting Standards.

Note. The split of the mark allocation is shown against each of the items above.

(Total = 20 marks)

Answers

A PLAN OF ATTACK

If this had been the real Diploma in International Financial Reporting exam and you had been told to turn over and begin, what would have been going through your mind?

Perhaps you're having a panic. You've spent most of your study time on groups and international financial reporting standards (because that's what your tutor/BPP Study Text advised you to do), and you're really not sure that you know enough. The good news is that you can always get a solid start by tackling the consolidation question. So calm down. Spend the first few moments or so **looking at the exam**, and develop a **plan of attack**.

Looking through the exam

The exam consists of **four compulsory questions**.

- Question 1 requires the calculation of goodwill as well as the preparation of a consolidated statement of profit or loss and other comprehensive income and a summarised consolidated statement of changes in equity. As usual you are required to incorporate the impact of various other accounting issues.
- Question 2 requires explanation of a number of different issues, including leases, joint arrangements and impairment of a trade receivable.
- Question 3 deals with non-current assets, specifically property, plant and equipment and intangible assets.
- Question 4 deals with first time adoption of IFRSs, financial assets, and share-based payments.

Group accounting question

You should be well-rehearsed in group accounts questions from your practice and revision. As usual with this type of question:

- Lay out the pro forma and slot in the figures as you calculate them.
- Write out workings as neatly as possible and cross-reference them to the statements.
- Save time by putting simple calculations on the face of the statements, rather than using a working.

Don't be tempted to go over time on this question. Remember that the 40-mark question should take you 78 minutes (including reading time). You will get most of your marks early on, so don't spend extra time looking for the errors or dealing with adjustments you are not sure of – go for the quick and easy marks in the time available.

Allocating your time

BPP's advice is always allocate your time **according to the marks for the question** in total and for the parts of the question. But always **use common sense**.

Forget about it!

And don't worry if you found the exam difficult. More than likely other candidates will too. The main thing is to keep your cool and be confident about what you know. And if this was the real exam, the only thing left to do is celebrate that it's over!

Question 1

Top tips. This is a typical group accounting question and at first sight it may look difficult. As usual, you should work methodically, taking each issue in turn. Always provide full and clear workings and reference each working to your main answer. The more simple workings can be done on the face of the statement of profit or loss. If you have practised similar questions, you should be able to make a good attempt at this one. In this question, the main issues are:

- Calculation of goodwill involving a share exchange, deferred consideration and fair value uplifts
- Acquisition of Gamma part-way through the reporting period
- Impairment of Beta's goodwill (cash-generating units)
- Intra-group revenue
- Hedge accounting for a cash-flow hedge
- Decommissioning provision

Remember to leave enough time to complete the summarised statement of changes in equity, which is worth 7 marks. You need to calculate opening equity and non-controlling interest, but these are relatively simple calculations.

Easy marks. As usual, there are easy marks for slotting the simpler figures into the two statements, or for some simple addition.

Examining team's comments. Overall, the examining team were pleased with students' performance in this question. The examiner reported that students did however struggle with the calculation of the impairment in Beta's goodwill as they were unable to correctly allocate the goodwill to cash generating units and complete the impairment in three 'slices'. Additionally some students struggled with the calculation of non-controlling interest and seemed unaware which consolidation adjustments affected it and which did not. As has been raised many times before, the students found part (c) on the preparation of a consolidated statement of changes in equity challenging. Ensure you study this area.

Marking scheme

			Marks
(a)	Computation of goodwill on acquisition of Beta and Gamma		
	\$'000	\$'000	<i>Explanations (where needed)</i>
<i>Beta</i>			
Cost of investment:			
Cash paid		150,000	½
Non-controlling interest at the date of acquisition		30,000	20,000 × \$1.50 ½
Net assets at the date of acquisition		(147,000)	½
<i>Goodwill on acquisition of Beta</i>		<u>33,000</u>	
<i>Gamma</i>			
Cost of investment:			
Share exchange	180,000		60 million × 2/3 × \$4.50 1
Deferred cash consideration	15,000		\$16.2 million/1.08 – the present value of the cash payable 1
Contingent consideration	<u>26,000</u>		Measured at fair value at the date of acquisition ½

			Marks
	221,000		
Non-controlling interest at the date of acquisition	<u>55,500</u>	20/80 × \$222 million (net assets of Gamma at date of acquisition – see below)	1
	276,500		
Net assets at the date of acquisition			
At 1 April 20X6	166,500	As per Gamma's financial statements	½
Profits to 31 July 20X6	13,500	4/12 × \$40.5 million (the profit for the year to 31 March 20X7)	1
Fair value uplifts	<u>42,000</u>	\$30 million + \$12 million as per – note 2	½
	(222,000)		
Goodwill on acquisition of Gamma	<u>54,500</u>		
			<u>7</u>

(b) ALPHA GROUP
CONSOLIDATED STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME
FOR THE YEAR ENDED 31 MARCH 20X7

	\$'000	
Revenue (W1)	858,000	1 (W1)
Cost of sales (W2)	<u>(503,110)</u>	9½ (W2)
Gross profit	354,890	
Distribution costs (26,000 + 20,000 + 18,000 × 8/12)	<u>(58,000)</u>	½
Administrative expenses (W5)	<u>(82,000)</u>	1½
Investment income (W6)	8,100	2½ (W6)
Other income (W7)	800	1 (W7)
Finance costs (W8)	<u>(56,992)</u>	3 (W8)
Profit before tax	166,798	
Income tax expense (24,000 + 14,000 + 8/12 × 13,500)	<u>(47,000)</u>	½
Profit for the year	119,798	
Other comprehensive income:		
Items that will be reclassified to profit and loss		
Effective portion of gains on derivatives classified as cash flow hedges	<u>4,200</u>	1
Total comprehensive income for the year	<u>123,998</u>	
Profit attributable to:		
Owners of Alpha (balancing figure)	105,848	½
Non-controlling interest (W9)	<u>13,950</u>	3½ (W9)
	119,798	
Total comprehensive income attributable to:		
Owners of Alpha (balancing figure)	110,048	½
Non-controlling interest (as above)	<u>13,950</u>	1
	<u>123,998</u>	
		<u>26</u>



(c) ALPHA GROUP

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 MARCH 20X7

	<i>Alpha group</i>	<i>Non-controlling</i>	<i>Total</i>	
	<i>\$'000</i>	<i>interest</i>	<i>\$'000</i>	
At 1 April 20X6				
(W10/11)	286,000 (W10)	39,200 (W11)	325,200	2 (W10) + 1 (W11)
Increase due to acquisition (W12)	206,000	55,500	261,500	1½ (W12)
Comprehensive income for the year	110,048	13,950	123,998	½ + ½
Dividends paid (W13)	(40,000)	(7,600) (W13)	(47,600)	½ + 1 (W13)
At 31 March 20X7	<u>562,048</u>	<u>101,050</u>	<u>663,098</u>	<u>7</u> <u>40</u>

Working 1 – Revenue

	<i>\$'000</i>	
Alpha + Beta + $\frac{8}{12} \times \text{Gamma}$	888,000	½
Intra-group revenue (20,000 + 10,000)	<u>(30,000)</u>	½
	<u>858,000</u>	<u>1</u>

Working 2 – Cost of sales

	<i>\$'000</i>	
Alpha + Beta + $\frac{8}{12} \times \text{Gamma}$	527,000	½
Intra-group purchases (as W1)	<u>(30,000)</u>	½
Unrealised profit:		
Closing inventory ($20\% \times (6,000 + 4,800)$)	2,160	½ + ½
Opening inventory ($20\% \times 4,000$)	<u>(800)</u>	½ + ½
Impairment of Beta goodwill (W3)	3,000	3½ (W3)
Extra depreciation on fair value adjustments:		
Plant and equipment ($12,000 \times \frac{1}{5} \times \frac{8}{12}$)	1,600	1
Extra depreciation of capitalised provision (W4)	<u>150</u>	<u>2 (W4)</u>
	<u>503,110</u>	<u>9½</u>

Working 3 – Impairment of Beta goodwill

	<i>Unit 1</i>	<i>Unit 2</i>	<i>Unit 3</i>	<i>Total</i>	
	<i>\$'000</i>	<i>\$'000</i>	<i>\$'000</i>	<i>\$'000</i>	
Net assets at 31 March 20X7 (as per SOCIE)	72,000	72,000	72,000	216,000	½
Allocated goodwill	<u>11,000</u>	<u>11,000</u>	<u>11,000</u>	<u>33,000</u>	½
	83,000	83,000	83,000	249,000	½
Recoverable amount	<u>87,000</u>	<u>84,000</u>	<u>80,000</u>		½
So impairment equals	<u>Nil</u>	<u>Nil</u>	<u>3,000</u>	<u>3,000</u>	½ + ½ + ½ 3½ ⇒ W2

Working 4 – Provision

	<i>\$'000</i>	
Provision required at 1 April 20X6 ($8,000 \times 0.30$)	<u>2,400</u>	1
So extra depreciation ($\frac{1}{16}$) equals	<u>150</u>	1
		2 ⇒ W2

Working 5 – Administrative expenses

	<i>\$'000</i>	
Alpha + Beta + $\frac{8}{12} \times \text{Gamma}$	90,000	½
Reversal of incorrectly charged provision	<u>(8,000)</u>	1
	<u>82,000</u>	<u>1½</u>



Marks

Working 6 – Investment income

	\$'000	
Alpha	28,000	½
Intra-group dividends eliminated:		½
– Beta ($80\% \times 18,000$)	(14,400)	½
– Gamma (paid post-acquisition – $75\% \times 16,000$)	(12,000)	½
Gain on remeasurement of FVTPL investments	6,500	½
	<u>8,100</u>	<u>2½</u>

Working 7 – Other income

	\$'000	
Ineffective portion of cash flow hedge ($5,000 - 4,200$)	800	<u>1</u>

Working 8 – Finance cost

	\$'000	
Alpha + Beta + $8/12 \times$ Gamma	56,000	½
Finance cost on deferred consideration ($15,000$ (part(a)) $\times 8\% \times 8/12$)	800	1½
Finance cost on decommissioning provision ($2,400$ (W4) $\times 8\%$)	192	1
	<u>56,992</u>	<u>3</u>

Working 9 – Non-controlling interest in profit

	Beta \$'000	Gamma (8/12) \$'000	Total \$'000	
Profit after tax	41,000	27,000		½ + ½
Impairment of Beta goodwill (W3)	(3,000)			½
Extra depreciation – Gamma (W2)		(1,600)		½
Relevant profit	<u>38,000</u>	<u>25,400</u>		½
Non-controlling interest (20%/25%)	<u>7,600</u>	<u>6,350</u>	<u>13,950</u>	½ + ½ <u>3½</u>

Working 10 – Opening equity – Alpha group

	\$'000	
Alpha	250,000	½
Beta: $80\% \times (193,000 - 147,000)$	36,800	½ + ½
Unrealised profit on opening inventory (W2)	(800)	½
	<u>286,000</u>	<u>2</u>

Working 11 – Opening non-controlling interest (in Beta)

	\$'000	
At date of acquisition (part (a))	30,000	½
Increase since acquisition: $20\% (193,000 - 147,000)$	9,200	½
At start of the year	<u>39,200</u>	<u>1</u>

Working 12 – Increase to equity as a result of the acquisition of Gamma

	\$'000	
Equity shares issued (part (a))	180,000	½
Contingent equity consideration (part (a))	26,000	½
So group element equals	206,000	1
Non-controlling interest in Gamma at the date of acquisition (part (a))	55,500	½
So total increase equals	<u>261,500</u>	<u>2½</u>

Working 13 – Dividends paid to non-controlling interest

	\$'000	
Beta ($18,000 \times 20\%$)	3,600	½
Gamma ($16,000 \times 25\%$)	4,000	½
Total	<u>7,600</u>	<u>1</u>

Question 2

Top tips. This question asked you to explain and show how the three events would be reported in the financial statements of Delta. In part (a) you had to correctly identify that the lease was a finance lease with Delta as the lessor. In part (b) you were required to identify that the arrangement was a joint operation, and that joint operators include their share of jointly held assets in their financial statements. In part (c) you had to remember that the review of a financial asset for impairment should be based upon conditions existing **at the reporting date** – in this scenario the event that led to going concern doubts occurred **after the reporting date** and therefore was non-adjusting. If you didn't spot this, remember it for next time. Remember that if the question asks for an **explanation**, you must provide this in your answer as even if you have the right accounting treatment, you won't score full marks if you have not explained it.

Easy marks. In part (a) as long as you were aware of the characteristics of a finance lease, there were some easy marks available in this question.

Examining team's comments. According to the examiner's report, there were some common mistakes made by students:

- Despite correctly identifying the lease as a finance lease in part (a), going on to say that lease rentals would be recognised by Delta as income in the statement of profit or loss, which is not correct.
- Not specifically stating that the joint arrangement in part (b) was a joint operation, rather than a joint venture.
- Lack of awareness of the fact that per IFRS 9 the review of a financial asset for impairment should be based upon conditions existing at the reporting date.

[References: IFRS 11: paras. 20–23; IFRS 16: paras. 61–80]

Marking scheme

	Marks
(a) It would appear that the lease of the asset to entity X is a finance lease. This is because entity X is responsible for repairs, maintenance and insurance of the asset and because the present value of the minimum lease payments by entity X is \$760,000 ($200,000 \times \3.80). This is 98.6% of the fair value of the asset at the inception of the lease (\$771,000).	1 (for decision) + 2 (for reasons)
Because the lease is a finance lease, Delta will show a lease receivable – net investment in finance leases under non-current assets.	1 (principle of this)
The carrying amount of the lease receivable on 1 April 20X6 will be \$791,000 (\$771,000 + \$20,000).	1
During the year ended 31 March 20X7, Delta will recognise income from finance leases in the statement of profit or loss. The amount recognised will be \$79,100 (\$791,000 × 10%).	1 (principle) + 1 (calculation)
Following recognition of the lease income and the rental payment from Delta on 31 March 20X7, the net investment in finance leases in the statement of financial position of Delta at 31 March 20X7 will be \$670,100 (\$791,000 + \$79,100 – \$200,000).	$\frac{1}{8}$



Marks

(b) The joint arrangement with entity Y is a joint operation because Delta and entity Y have equal rights to the assets and joint obligations for the liabilities relating to the arrangement.	1 (principle) + 1 (reason)
In a joint operation, the operators include their share of any jointly held assets. Therefore the property, plant and equipment of Delta at 31 March 20X7 will include:	1 (principle) + 1 (computation)
<ul style="list-style-type: none"> – Leasehold property of $\\$25\text{m} \times 24/25 = \\24m – Plant and equipment of $\\$7.5\text{m} \times 4/5 = \\6m 	
In a joint operation, the operators include their share of jointly incurred costs. Therefore the statement of profit or loss of Delta for the year ended 31 March 20X7 will include the following costs:	
<ul style="list-style-type: none"> – Amortisation of lease premium \$1m. – Depreciation of plant and equipment \$1.5m. – Cash cost of operating the depot \$4m. 	½ (principle) + 1½ (computation)
Delta will also include its own discretionary delivery charges of \$2m as a reduction in its operating costs.	<u>1</u> <u>7</u>
(c) Doubts regarding the going concern status of a customer would normally be regarded as <i>prima facie</i> evidence that any trade receivable had suffered impairment. In such circumstances an impairment allowance equal to the expected losses would normally be appropriate.	1
However, IFRS 9 <i>Financial Instruments</i> requires the impairment assessment to be made at the reporting date.	1
At the reporting date, the going concern status of Z was not in doubt, so in this case no allowance is necessary.	1
However, the information about the decline in the going concern status of Z after the reporting date is a non-adjusting event after the reporting date.	1
Therefore whilst no impairment allowance is necessary, it will be necessary to disclose details of the 20 April event at Z's business premises and its impact on the collectability of Delta's trade receivable.	<u>1</u> <u>5</u> <u>20</u>

Question 3

Top tips. This question provided you with the opportunity to demonstrate your knowledge in part (a) and there were plenty easy marks to obtain here. In part (b) you had to apply that knowledge to two situations. The first involved a property which should be partly classified as property, plant and equipment and partly as an investment property. The company had chosen to carry investment properties under the fair value model - remember that increases in value on investment property are credited to profit or loss and not to other comprehensive income. The tricky part of the brand was identifying that because there was no active market for it, the revaluation model could not be used.

Easy marks. Easy marks were available for the definitions in part (a).

Examining team's comments. The majority of candidates provided satisfactory answers to this question.

In part (a) some students thought that the investment property carried under the fair value model should be depreciated, which is incorrect. Depreciation of investment properties is only applicable to those carried under the cost model. In part (b) a considerable number of students missed the fact that the brand could not be carried under the revaluation model.

[References: IAS 1: para. 69; IAS 16: para. 6; IAS 38: para. 8]

Marking scheme

		Marks
(a)	(i)	
	IAS 1 distinguishes between current and non-current assets by identifying the meaning of the term 'current asset'.	½
	An asset is classified as current when the entity:	
	– Expects to realise the asset, or intends to sell or consume it, in its normal operating cycle.	½
	– Holds the asset primarily for the purpose of trading.	½
	– Expects to realise the asset within 12 months after the reporting period.	½
	– Has cash or a cash equivalent which is not subject to an exchange restriction.	½
	An entity classifies all other assets as non-current.	½
		<u>3</u>
	NB: Exact wordings NOT required for marks.	
	(ii)	
	IAS 16 defines property, plant and equipment as tangible items which are held for use in the production or supply of goods and services, for rental to others, or for administrative purposes and are expected to be used for more than one period .	½ + ½ ½ ½ + ½
	IAS 38 defines intangible assets as identifiable, non-monetary assets without physical substance .	½ + ½ ½
		<u>4</u>
	NB: Exact wordings NOT required for marks.	

	Marks
(b) (i) The property purchased for \$60 million is a mixed-use property. The property is being partly owner occupied and partly used for investment purposes. IAS 40 <i>Investment Property</i> states that where a property is held for mixed-use in this way, then the portions should be accounted for separately if they could be sold separately. This applies here.	1 (explanation)
The investment property has an 'effective original cost' of \$15 million.	½
Since the fair value model is being used to measure investment property, the investment property will not be depreciated but remeasured to fair value at 31 March 20X7, with gains or losses on remeasurement being recognised in profit or loss. Therefore the year-end carrying amount of the investment property will be \$16 million (\$64 million × 25%) and a remeasurement gain of \$1 million (\$16 million – \$15 million) will be recognised in profit or loss.	1 (explanation) + 1 (computation)
The investment property will be shown as a non-current asset in the statement of financial position.	½
Since the lease is an operating lease, Epsilon (as lessor) will recognise rental income of \$2 million in profit or loss for the year ended 31 March 20X7.	1
The remainder of the property, having an original cost of \$45 million (\$60 million – \$15 million), will be accounted for as property, plant and equipment and measured under the cost model.	1
The buildings component will be depreciated and the charge for the year ended 31 March 20X7 will be \$400,000 (\$20 million × 1/50). This charge will be recognised in profit or loss.	1
The carrying amount of the property, plant and equipment at 31 March 20X5 will be \$44.6 million (\$45 million – \$400,000). This will be shown as a non-current asset in the statement of financial position	<u>1</u> 8
(ii) Since the brand has been separately purchased, IAS 38 <i>Intangible Assets</i> requires that it is initially recognised at its cost of \$80 million.	1
Epsilon is unable to use the revaluation model to measure the brand because IAS 38 requires the existence of an active market in the asset before this can occur – this is clearly not present in this situation as the brand name is unique.	1
Under the cost model, intangible assets are amortised over their useful lives. If the useful life is assessed as indefinite, then no amortisation is charged but the asset must be reviewed annually for impairment.	2
In this case no impairment is evident as the value in use is \$85 million, so the brand will be shown as a non-current intangible asset at its original cost of \$80 million.	<u>1</u> 5 <u>20</u>

Question 4

Top tips. This was a typical discursive question, requiring you to explain three different issues to a trainee. Query 1 concerned first time adoption of IFRSs. This is the first time that IFRS 1 has been examined in a number of years, so it is likely that you found it quite tough.

Query 2 was the most difficult of the three issues. The question required knowledge of the basis for classification and subsequent accounting treatment of a financial asset – ie the business model under which the asset is held. If you missed this, go back to the chapter on financial instruments and revise it.

Query 3 was a share-based payment arrangement, with a focus on vesting conditions.

Easy marks. There were a few easy marks available in query 3 for stating the relevant requirements of IFRS 2.

Examining team's comments. The answers to query 1 were mixed. A disappointing minority of students misread the question completely and talked about the translation of the financial statements of an overseas subsidiary. Ensure you read the question carefully in the exam.

Many students struggled with query 2. A common error was to state that loan assets are always measured at amortised cost. A minority of students produced very good answers to this part of the question, indicating that careful study of the relevant standard pays dividends.

Answers to query 3 were generally good. However, there were two common errors:

- Basing the accounting charge on the number of employees at the year-end rather than the expected number of employees at the vesting date.
- Basing the accounting charge on the share price at the year-end rather than the option price at the grant date

[References: IFRS 1: paras. 6, 21, 24–28; IFRS 2: paras. 10–21; IFRS 9: paras. 4.1.1–4.1.2A]

Marking scheme

	Marks
Query One	
When an entity adopts International Financial Reporting Standards (IFRSs) for the first time, the entity needs to prepare an opening IFRS statement of financial position at the date of transition to IFRS. This is a requirement of IFRS 1 <i>First Time Adoption of International Financial Reporting Standards</i> .	1
The date of transition to IFRS is the beginning of the earliest period for which the entity provides comparative information. In our case, this date is 1 April 20X5.	1
The opening IFRS statement of financial position should be prepared in accordance with IFRSs which are in force for the current reporting period – in this case, the year ended 31 March 20X7.	1
The statement of profit or loss and other comprehensive income, and the statement of changes in equity, which are presented as comparative figures in the financial statements for the year ended 31 March 20X7, shall also be prepared in accordance with IFRSs which are in force for the year ended 31 March 20X7.	1
In the first set of financial statements we will need a reconciliation of those amounts which were previously reported under local standards in the previous year's financial statements.	1
The reconciliation will be between the amounts reported in previous periods under local standards and the equivalent amounts reported as comparatives in the current period under IFRSs.	1
For us, this will mean reconciling equity at 1 April 20X5 and 31 March 20X6, plus total comprehensive income for the year ended 31 March 20X6.	1
	<u>7</u>

Marks

Query Two

The measurement basis for financial assets is set out in IFRS 9 *Financial Instruments*. The measurement basis depends on the business model for managing the financial asset and the contractual cash flow characteristics of the financial asset.

1

In order for the financial asset to be measured at amortised cost, the contractual terms should give rise to cash flows on specified dates which are solely payments of principal and interest on the amounts outstanding. This condition is satisfied in the case of the loan you are querying.

1

There is, however, another condition to be satisfied. The asset should be held under a business model whose objective is to hold the financial asset in order to collect the contractual cash flows. This condition is not satisfied, given the possibility of assigning the loan should interest rates rise.

1

A financial asset is measured at fair value through other comprehensive income where the 'contractual cash flow test' is passed and the asset is held under a business model whose objective is achieved both by collecting the contractual cash flows and by selling the financial asset. This appears to be the case here, so classification as fair value through other comprehensive income seems appropriate.

1

Where a financial asset is measured at fair value through other comprehensive income, the interest income which is included in profit or loss is the same amount as would be recorded were the asset to be measured at amortised cost. Therefore interest income of \$2.5 million will be recorded in profit or loss.

1

The increase in fair value of \$2 million (\$52 million – \$50 million) will be recorded in other comprehensive income.

1
6

Query Three

Under the provisions of IFRS 2 *Share-based Payment*, this arrangement is an equity settled share-based payment.

1

IFRS 2 regulates the treatment of vesting conditions based on whether they are market based or non-market based.

1

A market based vesting condition is taken into account by reflecting it in the measurement of the fair value of the option. It does not need to be considered subsequently as to do so would result in double-counting. Therefore the condition relating to the share price can be ignored after the fair value of \$1 is determined.

1

A non-market condition is taken into account by reflecting it in the calculation of the number of options ultimately expected to vest. In this case, that number would be 90,000 (900×100).

1

The cost of the arrangement is recognised over the vesting period, based on the fair value of the option at the grant date.

1

The amount recognised for the year ended 31 March 20X7 would be \$18,000 ($90,000 \times \$1 \times 1/5$).

1

This amount is recognised as an employment cost (probably in profit or loss) and a corresponding credit to equity.

1
7
20

ACCA Diploma in International Financial Reporting BPP Mock Exam 3 (December 2017 exam)

Questions	
Time allowed	3 hours and 15 minutes
ALL FOUR questions are COMPULSORY and must be attempted	

Do NOT open this exam until instructed by the supervisor.

This exam must not be removed from the examination hall.

ALL FOUR questions are compulsory and MUST be attempted**Question 1**

Alpha has two subsidiaries, Beta and Gamma. The draft statements of financial position of the three entities at 30 September 20X7 are as follows:

	<i>Alpha</i> \$'000	<i>Beta</i> \$'000	<i>Gamma</i> \$'000
<i>Assets</i>			
<i>Non-current assets:</i>			
Property, plant and equipment (Note 2)	610,000	310,000	160,000
Investments (Note 1)	<u>370,700</u>	<u>Nil</u>	<u>Nil</u>
	<u>980,700</u>	<u>310,000</u>	<u>160,000</u>
<i>Current assets:</i>			
Inventories (Note 3)	140,000	85,000	66,000
Trade receivables	95,000	70,000	59,000
Cash and cash equivalents	<u>16,000</u>	<u>13,000</u>	<u>11,000</u>
	<u>251,000</u>	<u>168,000</u>	<u>136,000</u>
<i>Total assets</i>	<u>1,231,700</u>	<u>478,000</u>	<u>296,000</u>
<i>Equity and liabilities:</i>			
<i>Equity:</i>			
Share capital (\$1 shares)	240,000	120,000	100,000
Retained earnings	550,700	168,000	59,000
Other components of equity (Notes 2, 6 and 7)	<u>202,000</u>	<u>Nil</u>	<u>Nil</u>
Total equity	<u>992,700</u>	<u>288,000</u>	<u>159,000</u>
<i>Non-current liabilities:</i>			
Long-term borrowings (Note 7)	100,000	70,000	60,000
Deferred tax	<u>59,000</u>	<u>38,000</u>	<u>35,000</u>
<i>Total non-current liabilities</i>	<u>159,000</u>	<u>108,000</u>	<u>95,000</u>
<i>Current liabilities:</i>			
Trade and other payables	60,000	52,000	32,000
Short-term borrowings	<u>20,000</u>	<u>30,000</u>	<u>10,000</u>
<i>Total current liabilities</i>	<u>80,000</u>	<u>82,000</u>	<u>42,000</u>
<i>Total equity and liabilities</i>	<u>1,231,700</u>	<u>478,000</u>	<u>296,000</u>

Note 1 – Summary of Alpha's investments

The investments figure in the individual financial statements of Alpha is made up as follows:

	\$'000
Investment in Beta (Note 2)	236,500
Investment in Gamma (Note 3)	121,200
Other equity investments (Note 4)	<u>13,000</u>
	<u>370,700</u>

Note 2 – Alpha's investment in Beta

On 1 October 20X2, Alpha acquired 90 million shares in Beta by means of a share exchange of two shares in Alpha for every three shares acquired in Beta. On 1 October 20X2, the market value of an Alpha share was \$3.90. Alpha incurred directly attributable costs of \$2.5 million on acquisition of Beta relating to the cost of issuing its own shares.



On 1 October 20X2, the individual financial statements of Beta showed retained earnings of \$60 million.

The directors of Alpha carried out a fair value exercise to measure the identifiable assets and liabilities of Beta at 1 October 20X2. The following matters emerged:

- Property which had a carrying amount of \$150 million (land component \$45 million) had an estimated fair value of \$210 million (land component \$66 million). The buildings component of the property had an estimated remaining useful life of 30 years at 1 October 20X2.
- Plant and equipment which had a carrying amount of \$122 million had an estimated fair value of \$145 million. The estimated remaining useful life of the plant at 1 October 20X2 was four years.
- On 1 October 20X2, the directors of Alpha identified a brand name relating to Beta which had a fair value of \$25 million. This brand name was not recognised in the individual financial statements of Beta as it was internally developed. The directors of Alpha considered that the useful life of the brand name was 25 years from 1 October 20X2.
- The fair value adjustments have not been reflected in the individual financial statements of Beta. In the consolidated financial statements, the fair value adjustments will be regarded as temporary differences for the purposes of calculating deferred tax. The rate of deferred tax to apply to temporary differences is 20%.

No impairment of the goodwill on acquisition of Beta has been evident since 1 October 20X2. On 1 October 20X2, the directors of Alpha initially measured the non-controlling interest in Beta at its fair value on that date. On 1 October 20X2, the fair value of an equity share in Beta (which can be used to measure the fair value of the non-controlling interest) was \$2.35.

Note 3 – Alpha's investment in Gamma

On 1 October 20X6, Alpha acquired 80 million shares in Gamma by means of a cash payment of \$120 million. Alpha incurred due diligence costs of \$1.2 million associated with this purchase. The purchase agreement provided for an additional cash payment of \$56 million to the former holders of the 80 million acquired shares on 1 October 20X8. An appropriate annual discount rate to use in any relevant discounting to measure the fair value of this additional cash payment is 8%.

On 1 October 20X6, the individual financial statements of Gamma showed retained earnings of \$50 million.

On 1 October 20X6, the fair values of the net assets of Gamma were the same as their carrying amount with the exception of some inventory which was recognised in the individual financial statements of Gamma at a cost of \$12 million. The directors of Alpha considered that this inventory had a fair value of \$15 million on 1 October 20X6. This inventory was all sold by Gamma prior to 30 September 20X7. The fair value adjustment was not reflected in the individual financial statements of Gamma. In the consolidated financial statements, the fair value adjustment will be regarded as a temporary difference for the purposes of calculating deferred tax. The rate of deferred tax to apply to temporary differences is 20%.

No impairment of the goodwill on acquisition of Gamma has been evident since 1 October 20X6. On 1 October 20X6, the directors of Alpha initially measured the non-controlling interest in Gamma at its fair value on that date. On 1 October 20X6, the fair value of an equity share in Gamma was \$1.75.

Note 4 – Other equity investments by Alpha

Alpha has a portfolio of equity investments which are classified in accordance with IFRS 9 *Financial Instruments* as 'fair value through profit or loss'. The carrying amount included in the financial statements of Alpha represents the fair value of the portfolio at 1 October 20X6, which has been correctly adjusted for purchases and disposals in the year. The fair value of the portfolio at 30 September 20X7 was \$13.8 million.

Note 5 – Trade receivables and payables

On 29 September 20X7, Gamma made a payment of \$8 million to Beta to eliminate the intra-group balances at that date. This payment was received and recorded by Beta on 2 October 20X7.

Note 6 – Share-based payment

On 1 October 20X5, Alpha granted 200 senior managers options to buy 100,000 shares each between 30 September 20X8 and 31 December 20X8. The options are due to vest on 30 September 20X8 provided the relevant managers remain employed over the three-year vesting period ending on that date. Since 1 October 20X5 the expectation of the number of managers for whom the options would vest has varied as follows:

<i>Date</i>	<i>Expected number of managers for whom the options will vest</i>
1 October 20X5	200
30 September 20X6	180
30 September 20X7	190

In preparing the financial statements of Alpha for the year ended 30 September 20X6, the directors of Alpha debited retained earnings and credited other components of equity with the appropriate amount required by IFRS 2 *Share-based Payment*. The directors of Alpha have made no additional accounting entries in respect of the options in the draft financial statements for the year ended 30 September 20X7.

On 1 October 20X5, the fair value of one option was estimated to be \$1.20. The fair value of the same option at 30 September 20X6 and 20X7 was estimated to be \$1.25 and \$1.30 respectively.

Note 7 – Long-term borrowing

On 1 October 20X6, Alpha issued 60 million \$1 loan notes at par. The annual rate of interest (payable in arrears) on the loan notes is 6%. The loan notes are repayable at par on 30 September 20Y6. As an alternative to repayment, the holders of the loan notes can elect to convert their loan notes into equity shares of Alpha on 30 September 20Y6. Had the conversion option not been available, the investors in the loan notes would have required an annual return of 9%.

Discount factors which may be relevant at 6% and 9% are as follows:

<i>Discount rate</i>	<i>Present value of \$1 receivable in 10 years</i>	<i>Present value of \$1 receivable at the end of years 1–10</i>
6%	55.8 cents	\$7.36
9%	42.2 cents	\$6.42

In preparing the draft financial statements for the year ended 30 September 20X7, the directors of Alpha credited \$60 million to long-term borrowings and showed the interest paid to the investors as a finance cost.

Required

Prepare the consolidated statement of financial position of Alpha at 30 September 20X7. You need only consider the deferred tax implications of any adjustments you make where the question specifically refers to deferred tax.

(40 marks)

Question 2

Delta prepares its financial statements to 30 September each year. The financial statements for the year ended 30 September 20X7 are shortly to be authorised for issue. The following events are relevant to these financial statements:

- (a) Delta operates a defined benefit retirement benefits plan on behalf of current and former employees. Delta receives advice from actuaries regarding contribution levels and overall liabilities of the plan to pay benefits. On 1 October 20X6, the actuaries advised that the present value of the defined benefit obligation was \$60 million. On the same date, the fair value of the assets of the defined benefit plan was \$52 million. On 1 October 20X6, the annual market yield on high quality corporate bonds was 5%.

During the year ended 30 September 20X7, Delta made contributions of \$7 million into the plan and the plan paid out benefits of \$4.2 million to retired members. You can assume that both these payments were made on 30 September 20X7.

The actuaries advised that the current service cost for the year ended 30 September 20X7 was \$6.2 million. On 31 August 20X7, the rules of the plan were amended with retrospective effect. These amendments meant that the present value of the defined benefit obligation was increased by \$1.5 million from that date.

During the year ended 30 September 20X7, Delta was in negotiation with employee representatives regarding planned redundancies. The negotiations were completed shortly before the year end and redundancy packages were agreed. The impact of these redundancies was to reduce the present value of the defined benefit obligation by \$8 million. Before 30 September 20X7, Delta made payments of \$7.5 million to the employees affected by the redundancies in compensation for the curtailment of their benefits. These payments were made out of the assets of the retirement benefits plan.

On 30 September 20X7, the actuaries advised that the present value of the defined benefit obligation was \$68 million. On the same date, the fair value of the assets of the defined benefit plan were \$56 million.

(11 marks)

- (b) On 1 April 20X7, Delta completed the construction of a power generating facility. The total construction cost was \$20 million. The facility was capable of being used from 1 April 20X7 but Delta did not bring the facility into use until 1 July 20X7. The estimated useful life of the facility at 1 April 20X7 was 40 years.

Under legal regulations in the jurisdiction in which Delta operates, there are no requirements to restore the land on which power generating facilities stand to its original state at the end of the useful life of the facility. However, Delta has a reputation for conducting its business in an environmentally friendly way and has previously chosen to restore similar land even in the absence of such legal requirements. The directors of Delta estimated that the cost of restoring the land in 40 years' time (based on prices prevailing at that time) would be \$10 million. A relevant annual discount rate to use in any discounting calculations is 5%. When the annual discount rate is 5%, the present value of \$1 receivable in 40 years' time is approximately 14.2 cents.

(9 marks)

Required

Explain and show how the two events would be reported in the financial statements of Delta for the year ended 30 September 20X7. When considering the reporting of events in the statement of comprehensive income, you should distinguish between events being reported in profit or loss from events being reported in other comprehensive income, where this is relevant. However, you do not need to comment on potential future reclassification issues.

Note. The mark allocation is shown against both of the two events above.

(Total = 20 marks)

Question 3

IFRS 16 *Leases* was issued in January 2016 and applies to accounting periods beginning on or after 1 January 2019. However, earlier application is permitted. IFRS 16 replaces IAS 17 *Leases*. IFRS 16 makes substantial changes to the requirements for the recognition of rights and obligations under leasing arrangements for lessees.

Required

- (a) Explain:
- (i) Why the International Accounting Standards Board considered it necessary to make significant changes to the requirements for the recognition of rights and obligations under leasing arrangements in the financial statements of lessees. (4 marks)
 - (ii) How IFRS 16 requires lessees to recognise and measure rights and obligations under leasing arrangements. (4 marks)
 - (iii) Any exceptions to the usual requirements you have outlined in (ii) above. Your answer should briefly describe the accounting treatment required in the case of such exceptions and, where appropriate, the types of assets which these exceptions might apply to. (4 marks)

Kappa prepares financial statements to 30 September each year. On 1 October 20X6, Kappa began to lease a property on a ten-year lease. The annual lease payments were \$500,000, payable in arrears – the first payment being made on 30 September 20X7. Kappa incurred initial direct costs of \$60,000 in arranging this lease. The annual rate of interest implicit in the lease is 10%. When the annual discount rate is 10%, the present value of \$1 payable at the end of years 1–10 is 6.145 dollars.

Required

- (b) Explain and show how these transactions would be reported in the financial statements of Kappa for the year ended 30 September 20X7 under IFRS 16 *Leases*. (8 marks)

(Total = 20 marks)

Question 4

You are the financial controller of Omega, a listed entity which prepares consolidated financial statements in accordance with International Financial Reporting Standards (IFRS). You have recently prepared the financial statements for the year ended 30 September 20X7 and these are due to be published shortly. The managing director has reviewed these financial statements and has prepared a list of queries arising out of the review.

Query One

I'm confused about our treatment of equity investments in listed entities that we don't control. There seem to be two different treatments in our financial statements. One of the notes to the financial statements says that the equity investments we hold to temporarily invest surplus cash balances are measured at fair value and that changes in fair value are recognised in profit or loss. Another note says that the equity investment we hold in a key supplier is measured at fair value and that changes in fair value are recognised in other comprehensive income (OCI). Earnings per share (EPS) is a key performance indicator for Omega, so please explain how it can be justified to use two different treatments for equity investments made by the same entity. Please also explain what the impact on EPS might be if a gain or loss is reported in OCI rather than profit or loss. (6 marks)

Query Two

I noticed that OCI includes a gain of \$64 million relating to the revaluation of our portfolio of properties. I looked in the notes to check that a corresponding amount of \$64 million had been added to property, plant and equipment. However, the note explaining movements in property, plant and equipment showed a revaluation increase of \$80 million. There was a reference to tax in one of the notes I looked at but I don't see why this is relevant. I know our rate of tax is 20% and this would explain the difference but we won't pay any tax on this gain unless we sell the properties. We have no intention of selling any of them in the foreseeable future, so what relevance does tax have? Please explain the difference between the \$64 million gain in OCI and the \$80 million gain added to property, plant and equipment. (6 marks)

Query Three

I'm aware that on 31 December 20X6 we acquired a new subsidiary and therefore its results and net assets are included in our consolidated financial statements for the year ended 30 September 20X7. I seem to recall from the discussions we held at the time that the year end of this subsidiary is 31 May rather than 30 September. How do we deal with the fact that the year ends are different when we prepare the consolidated financial statements? Do we have to prepare additional special information for this subsidiary when we consolidate? (4 marks)

Query Four

As you know, my son owns a business that supplies us with a very small proportion of the components that we use in our production process. This business is one of a number that supply us with these components and the overall quantity is totally insignificant to us. I was very surprised to see that details of these transactions with my son's business have been disclosed in the notes to the draft financial statements. This seems ridiculous when transactions with far more significant suppliers are not disclosed at all. Please explain the rationale of this disclosure to me. (4 marks)

Required

Provide answers to the queries raised by the managing director. You should justify your answers with reference to relevant International Financial Reporting Standards.

Note. The mark allocation is shown against each of the four queries above.

(Total = 20 marks)

Answers

A PLAN OF ATTACK

If this had been the real Diploma in International Financial Reporting exam and you had been told to turn over and begin, what would have been going through your mind?

Perhaps you're having a panic. You've spent most of your study time on groups and international financial reporting standards (because that's what your tutor/BPP Study Text advised you to do), and you're really not sure that you know enough. The good news is that you can always get a solid start by tackling the consolidation question. So calm down. Spend the first few moments or so **looking at the exam**, and develop a **plan of attack**.

Looking through the exam

The exam consists of **four compulsory questions**.

- Question 1 requires a consolidated statement of financial position for a parent with two subsidiaries. As usual you are required to incorporate the impact of various other accounting issues.
- Question 2 requires explanation of the accounting for a defined benefit obligation and the construction of a power plant with a decommissioning liability.
- Question 3 deals with IFRS 16 *Leases*.
- In Question 4, you are the financial controller and have to deal with queries from the managing director regarding equity investments, revaluation of property and the tax effects, consolidation issues and related party disclosures.

Group accounting question

You should be well-rehearsed in group accounts questions from your practice and revision. As usual with this type of question:

- Lay out the pro forma and slot in the figures as you calculate them.
- Write out workings as neatly as possible and cross-reference them to the statements.
- Save time by putting simple calculations on the face of the statements, rather than using a working.

Don't be tempted to go over time on this question. Remember that the 40-mark question should take you 78 minutes (including reading time). You will get most of your marks early on, so don't spend extra time looking for the errors or dealing with adjustments you are not sure of – go for the quick and easy marks in the time available.

Allocating your time

BPP's advice is always allocate your time **according to the marks for the question** in total and for the parts of the question. But always **use common sense**.

Forget about it!

And don't worry if you found the exam difficult. More than likely other candidates will too. The main thing is to keep your cool and be confident about what you know. And if this was the real exam, the only thing left to do is celebrate that it's over!

Question 1

Top tips. In this question, the parent had two subsidiaries that had been owned for the entire accounting period. One of the subsidiaries was purchased by means of a share exchange and had several fair value adjustments on acquisition to take account of. The consideration for the other subsidiary included a deferred payment and there was also an inventory fair value adjustment which had a deferred tax effect to deal with. There were some fairly tricky issues to deal with for the parent entity, including some financial instruments, share-based payment and a convertible loan. All in all, this is a typical group accounting question. As usual, you should work methodically, providing full and clear workings and referencing each working to your main answer. The more simple workings can be done on the face of the statement of financial position. If you have practised similar questions, you should be able to make a good attempt at this one.

Easy marks. As usual, there are easy marks for slotting the simpler figures into the two statements, or for some simple addition.

Examining team's comments. Overall, the examining team were pleased with students' performance in this question. There were however, some recurring errors:

- Providing for only one year's additional post-acquisition depreciation and amortisation on the fair value adjustments relating to the non-current assets of Beta at the date of its acquisition.
- Treating the fair value adjustment to the inventory of Gamma at the date of acquisition as an adjustment to the carrying value of consolidated inventory at the reporting date. The question clearly stated that the inventory of Gamma at the date of its acquisition by Alpha had all been sold prior to the reporting date.
- Adjusting the cash in transit from Gamma to Beta at the reporting date by (correctly) reducing consolidated trade receivables but (incorrectly) reducing trade payables rather than increasing cash.
- Showing the adjustment to the carrying value of Alpha investments classified as 'fair value through profit or loss' as a credit to 'other components of equity' rather than retained earnings.
- Incorrectly computing the cumulative share-based payment adjustment by failing to use the fair value of the share options at the grant date and/or failing to account for the adjustment proportionally over the vesting period.
- Computing the cumulative share-based adjustment (either correctly or incorrectly) but then failing to appreciate that only the current period adjustment needed to be provided for since (as stated in the question) the prior-year accounting was correct.
- Incorrectly computing the 'loan element' of the convertible loan. Common errors here included computing the loan element as the present value of the principal repayment only or computing the loan element as the present value of the principal repayment plus only the first year's interest payment.

Marking scheme

Marks

CONSOLIDATED STATEMENT OF FINANCIAL POSITION OF ALPHA
AT 30 SEPTEMBER 20X7

	\$'000	
Assets		
<i>Non-current assets:</i>		
Property, plant and equipment (610,000 + 310,000 + 160,000) + [60,000 – 6,500] (W1))	1,133,500	½ + ½
Goodwill (W3)	88,711	9½ (W3)
Brand name (W1)	20,000	½
Investments	13,800	½
	<u>1,256,011</u>	
<i>Current assets:</i>		
Inventories (140,000 + 85,000 + 66,000)	291,000	½
Trade receivables (95,000 + 70,000 + 59,000 – 8,000 (intra-group))	216,000	½ + ½
Cash and cash equivalents (16,000 + 13,000 + 11,000 + 8,000 (cash in transit))	48,000	½ + ½
	<u>555,000</u>	
Total assets	<u><u>1,811,011</u></u>	
<i>Equity and liabilities</i>		
<i>Equity attributable to equity holders of the parent</i>		
Share capital	240,000	½
Retained earnings (W5)	603,280	16 (W5)
Other components of equity (W8)	219,068	2½ (W8)
	<u>1,062,348</u>	
Non controlling interest (W4)	126,920	2 (W4)
Total equity	<u><u>1,189,268</u></u>	
<i>Non-current liabilities:</i>		
Long term borrowings (W9)	219,191	2 (W9)
Deferred consideration (W10)	51,852	1 (W10)
Deferred tax (W11)	146,700	1 (W11)
Total non current liabilities	<u><u>417,743</u></u>	
<i>Current liabilities:</i>		
Trade and other payables (60,000 + 52,000 + 32,000)	144,000	½
Short term borrowings (20,000 + 30,000 + 10,000)	60,000	½
Total current liabilities	<u><u>204,000</u></u>	<u>40</u>
Total equity and liabilities	<u><u>1,811,011</u></u>	



Marks

WORKINGS – DO NOT DOUBLE COUNT MARKS. ALL NUMBERS IN \$'000 UNLESS OTHERWISE STATED.

Working 1 – Net assets table – Beta

	1 October 20X2 \$'000	30 September 20X7 \$'000	For W3	For W5
Share capital	120,000	120,000	½	
Retained earnings:				
Per accounts of Beta	60,000	168,000	½	½
Fair value adjustments:				
Property (210,000 – 150,000)	60,000	60,000	½	½
Extra depreciation due to buildings uplift ((144,000 – 105,000) × 5/30)		(6,500)		½
Plant and equipment (145,000 – 122,000)	23,000	Nil	½	½
Brand	25,000	25,000	½	½
Extra amortisation due to brand uplift (25,000 × 5/25)		(5,000)		½
Deferred tax on fair value adjustments:				
Date of acquisition (20% × 108,000 (see above))	(21,600)		½	
Year end (20% × 73,500 (see above))		(14,700)		½
Net assets for the consolidation	<u>266,400</u>	<u>346,800</u>		
The post-acquisition increase in net assets is 80,400 (346,000 – 266,40)				½
			<u>3</u>	<u>4</u>
			⇒W3	⇒W4

Working 2 – Net assets table – Gamma

	1 October 20X6 \$'000	30 September 20X7 \$'000	For W3	For W5
Share capital	100,000	100,000	½	
Retained earnings:	50,000	59,000	½	½
Inventory adjustment	3,000	Nil	½	½
Deferred tax on inventory value adjustment:				
Date of acquisition (20% × 3,000 (see above))	(600)		½	
Year end (20% × nil (see above))		Nil		½
Net assets for the consolidation	<u>152,400</u>	<u>159,000</u>		
The post-acquisition increase in net assets is 6,600 (159,000 – 152,400)				½
			<u>2</u>	<u>2</u>
			⇒W3	⇒W5



Marks

Working 3 – Goodwill on consolidation

	Beta \$'000	Gamma \$'000	
Cost of investment:			
Shares issued to acquire Beta (90,000 × 2/3 × \$3.90)	234,000		1
Cash paid to acquire shares in Gamma		120,000	½
Deferred consideration re: Gamma acquisition (56,000/(1.08) ²)		48,011	1
Non-controlling interests at date of acquisition:			
Beta – 30,000 × \$2.35	70,500		½ + ½
Gamma – 20,000 × \$1.75		35,000	½ + ½
Net assets at date of acquisition (W1/W2)	(266,400) <u>38,100</u>	(152,400) <u>50,611</u>	3 (W1) + 2 (W2) <u>9½</u>
The total goodwill is 88,711 (38,100 + 50,611)			

Working 4 – Non-controlling interests

	Beta \$'000	Gamma \$'000	
At date of acquisition (W3)	70,500	35,000	½ + ½
Share of post-acquisition increase in net assets per workings 1 and 2:			
Beta – 25% × 80,400 (W1)	20,100		½
Gamma – 20% × 6,600 (W2)		1,320	½
	<u>90,600</u>	<u>36,320</u>	<u>2</u>
The total NCI is 126,920 (90,600 + 36,320)			

Working 5 – Retained earnings

	\$'000	
Alpha	550,700	½
Adjustment for acquisition costs:		
Gamma	(1,200)	½
Finance cost on deferred consideration (8% × 48,011 (W3))	(3,841)	1
Alpha revaluation of FVTPL investments (13,800 – 13,000)	800	1
Additional charge for share based payment (W6)	(8,000)	2½ (W6)
Additional finance cost on convertible loan (W7)	(759)	3 (W7)
Beta (75% × 80,400 (W1))	60,300	½ + 4 (W1)
Gamma (80% × 6,600 (W2))	5,280	½ + 2 (W2)
	<u>603,280</u>	<u>15½</u>

Working 6 – Additional charge for share-based payment

	\$'000	
Closing cumulative charge required \$(190 × 100,000 × \$1.20 × 2/3)	15,200	½ + ½ + ½
Opening amount already taken to other components of equity \$(180 × 100,000 × \$1.20 × 1/3)	(7,200)	½ + ½
So additional charge required is	<u>8,000</u>	<u>2½</u> ⇒ W5

Marks

Working 7 – Convertible loan

	\$'000	
Loan element		
Present value of interest stream ($60,000 \times 6\% \times 6.42$)	23,112	1
Present value of repayment amount ($60,000 \times 0.422$)	25,320	1
So loan component is	48,432	
Annual finance cost at 9% is	4,359	$\frac{1}{2}$
Finance cost charged in draft financial statements of Alpha ($60,000 \times 6\%$)	(3,600)	$\frac{1}{2}$
So adjustment equals	<u>759</u>	<u>3</u>
		⇒ W5

Working 8 – Other components of equity

	\$'000	
Alpha – per own financial statements	202,000	$\frac{1}{2}$
Cost of shares issued to acquire Beta	(2,500)	$\frac{1}{2}$
Adjustment caused by share based payment (W6)	8,000	$\frac{1}{2}$
Equity component of convertible loan ($60,000 - 48,432$ (W7))	<u>11,568</u>	<u>1</u>
	<u>219,068</u>	<u>2½</u>

Working 9 – Long-term borrowings

	\$'000	
Alpha + Beta + Gamma	230,000	$\frac{1}{2}$
Remove incorrect carrying value of convertible	(60,000)	$\frac{1}{2}$
Add correct carrying value of convertible ($48,432 + 759$ (W7))	<u>49,191</u>	<u>$\frac{1}{2} + \frac{1}{2}$</u>
	<u>219,191</u>	<u>2</u>

Working 10 – Deferred consideration

	\$'000	
At date of acquisition (W3)	48,011	$\frac{1}{2}$
Finance cost to 30 September 20X7 (W5)	<u>3,841</u>	<u>$\frac{1}{2}$</u>
	<u>51,852</u>	<u>1</u>

Working 11 – Deferred tax

	\$'000	
Alpha + Beta + Gamma	132,000	$\frac{1}{2}$
On fair value adjustments in Beta (W1)	<u>14,700</u>	<u>$\frac{1}{2}$</u>
	<u>146,700</u>	<u>1</u>

Question 2

Top tips. This question asked you to explain and show how two events would be reported in the financial statements of Delta. In part (a) you were required to explain and show how the pension obligation would be reported in the financial statements. You are not asked for extracts here, but if you did provide those, credit would be given. The important point is to note that you must **explain** the accounting treatment, not just calculate numbers. In part (b) you had to identify that although Delta was not legally obliged to restore the land, it had a **constructive obligation** to do so based on its policies and previous actions.

Easy marks. There were a few easy marks available for stating the basics of the accounting treatment in each case.

Examining team's comments. The examiner commented that: 'where explanations are required, marks will be specifically awarded for such explanations and full marks will not be obtained if the explanations are not provided, even where the accounting treatment provided is correct. This was particularly an issue in part (a) of this question. A significant minority of candidates simply computed the re-measurement loss arising on the actuarial valuation of the plan without any explanations whatsoever of the accounting treatment of the constituent elements of the reconciliation. The computation of the re-measurement loss was often correct but such candidates only scored around half marks by not displaying the knowledge they apparently possessed in the form of supporting explanations' (Examiner's Report December 2017). Ensure you provide explanations of your workings where these are asked for in the question.

[References: IAS 19: paras. 55–98]

Marking scheme

	Marks
(a) All numbers in \$'000 unless otherwise stated	
On 30 September 20X7, Delta will report a net pension liability in the statement of financial position. The amount of the liability will be 12,000 (68,000 – 56,000).	½ + ½
For the year ended 30 September 20X7, Delta will report the current service cost as an operating cost in the statement of profit or loss. The amount reported will be 6,200 . The same treatment applies to the past service cost of 1,500.	½ + ½ + ½
For the year ended 30 September 20X7, Delta will report a finance cost in profit or loss based on the net pension liability at the start of the year of 8,000 (60,000 – 52,000). The amount of the finance cost will be 400 (8,000 × 5%).	½ + ½ + ½
The redundancy programme represents the partial settlement of the curtailment of a defined benefit obligation. The gain on settlement of 500 (8,000 – 7,500) will be reported in the statement of profit or loss.	½ + ½
Other movements in the net pension liability will be reported as remeasurement gains or losses in other comprehensive income .	½ + ½
For the year ended 30 September 20X7, the remeasurement loss will be 3,400 (working).	<u>5</u>
	<u>11</u>

	Marks
(b) The facility is depreciated from the date it is ready for use, rather than when it actually starts being used. In this case, then, the facility is depreciated from 1 April 20X7 .	$\frac{1}{2} + \frac{1}{2}$
Although Delta has no legal obligation to restore the piece of land, it does have a constructive obligation , based on its past practice and policies .	$\frac{1}{2} + \frac{1}{2}$
The amount of the obligation will be 1,420 , being the present value of the anticipated future restoration expenditure ($10,000 \times 0.142$).	$\frac{1}{2} + \frac{1}{2}$
This will be recognised as a provision under non-current liabilities in the statement of financial position of Delta at 30 September 20X7.	$\frac{1}{2} + \frac{1}{2}$
As time passes the discounted amount unwinds . The unwinding of the discount for the year ended 30 September 20X7 will be 35.5 ($1,420 \times 5\% \times 6/12$).	$\frac{1}{2} + \frac{1}{2} + \frac{1}{2}$
The unwinding of the discount will be shown as a finance cost in the statement of profit or loss and the closing provision will be 1,455.5 ($1,420 + 35.5$).	$\frac{1}{2} + \frac{1}{2}$
The initial amount of the provision is included in the carrying amount of the non-current asset, which becomes 21,420 ($20,000 + 1,420$).	$\frac{1}{2} + \frac{1}{2}$
The depreciation charge in profit or loss for the year ended 30 September 20X7 is 267.75 ($21,420 \times 1/40 \times 6/12$).	$\frac{1}{2} + \frac{1}{2}$
The closing balance included in non-current assets will be 21,152.25 ($21,420 - 267.75$).	$\frac{1}{2}$
	<u>9</u>
	<u>20</u>

Working for part (a) – remeasurement gain or loss

	\$'000	
Liability at the start of the year (60,000 – 52,000)	8,000	$\frac{1}{2}$
Current service cost	6,200	$\frac{1}{2}$
Past service cost	1,500	$\frac{1}{2}$
Net finance cost	400	$\frac{1}{2}$
Gain on settlement	(500)	$\frac{1}{2}$
Contributions to plan	(7,000)	$\frac{1}{2}$
Benefits cancel out		$\frac{1}{2}$
Remeasurement loss (balancing figure)	<u>3,400</u>	$\frac{1}{2} + \frac{1}{2}$
Liability at the end of the year (68,000 – 56,000)	<u>12,000</u>	$\frac{1}{2}$
		<u>5</u>



Question 3

Top tips. This question provided you with the opportunity to demonstrate your knowledge in part (a) and there were plenty easy marks to obtain here provided you had studied IFRS 16. In part (b) you had to apply that knowledge to two situations. The first involved a property which should be partly classified as property, plant and equipment and partly as an investment property. The company had chosen to carry investment properties under the fair value model – remember that increases in value on investment property are credited to profit or loss and not to other comprehensive income. The tricky part of the brand was identifying that because there was no active market for it, the revaluation model could not be used.

Easy marks. Easy marks were available for the definitions in part (a).

Examining team's comments. The examiner stated that: 'On the whole, answers to this question were not as good as they might have been. It was obvious that many candidates were not aware of the new leasing standard or that it was examinable in December 2017. This clearly meant that such candidates scored very few marks in part (a) of this question' (Examiner's Report December 2017). You are reminded that new standards are always ripe for examination – therefore do not neglect these in your studies.

[References: IFRS 16: paras. 5–8, 22–38]

Marking scheme

	Marks
(a) (i) IAS 17 – the previous financial reporting standard dealing with leasing – distinguished between two types of lease: finance and operating.	½
IAS 17 required lessees to recognise rights and obligations under leasing arrangements in the case of finance leases but not in the case of operating leases.	1
The distinction between finance leases and operating leases in IAS 17 was very subjective.	½
Generally speaking, classifying leases as operating leases led to financial statements of lessees reporting a more favourable picture than classifying leases as finance leases.	1
This incentive to treat leases as operating leases, together with the subjective nature of lease classification, meant that the requirements in IAS 17 needed amending.	<u>1</u> <u>4</u>
(ii) IFRS 16 requires lessees to recognise a right-of-use asset and an associated liability at the inception of the lease.	1
The initial measurement of the right-of-use asset and the lease liability will be the present value of the minimum lease payments.	1
The discount rate used to measure the present value of the minimum lease payments is the rate of interest implicit in the lease – essentially the rate of return earned by the lessor on the leased asset. If this rate is not available to the lessee, then a commercial rate of interest can be used instead.	½
The right-of-use asset is subsequently depreciated in accordance with IAS 16 <i>Property, Plant and Equipment</i> (assuming it is a tangible asset).	½

The lease liability is effectively treated as a financial liability which is measured at amortised cost, using the rate of interest implicit in the lease as the effective interest rate.

1
4

- (iii) **A short-term lease** is a lease which, at the date of commencement, has a term of 12 months or less. Lessees can **elect to treat short-term leases by recognising the lease rentals as an expense over the lease term rather than recognising a 'right-of-use asset' and a lease liability.**

1 + 1

A similar election – *on a lease-by-lease basis* – can be made in respect of 'low value assets'.

1

Examples of low-value underlying assets can include tablet and personal computers, small items of office furniture and telephones. **(Note. Any reasonable attempt to describe a 'low-value' asset would receive credit.)**

1
4

- (b) The initial right-of-use asset and lease liability would be \$3,072,500 ($500,000 \times 6.145$).

1

The initial direct costs of the lessee would be added to the right-of-use asset to give an initial carrying amount of \$3,132,500 ($\$3,072,500 + \$60,000$).

1

Depreciation would be charged over a ten-year period, so the charge for the year ended 30 September 20X7 would be \$313,250 ($\$3,132,500 \times 1/10$).

1

The closing carrying amount of PPE in non-current assets would be \$2,819,250 ($\$3,132,500 \times 9/10$).

1

Kappa would recognise a finance cost in profit or loss of \$307,250 ($\$3,072,500 \times 10\%$).

1

The closing lease liability would be \$2,879,750 ($\$3,072,500 + \$307,250 - \$500,000$).

1

Next year's finance cost will be \$287,975 ($\$2,879,750 \times 10\%$), so the current liability at 30 September 20X7 will be \$212,025 ($\$500,000 - \$287,975$).

$\frac{1}{2} + 1$

The balance of the liability of \$2,667,725 ($\$2,879,750 - \$212,025$) will be non-current.

$\frac{1}{2}$
8
20

Question 4

Top tips. This was a typical discursive question, requiring you, as financial controller, to explain four different issues to the managing director. Query 1 concerned the different treatments required for equity investments. The question gave you the accounting treatment – you had to spot why this was the case for the different investments, ie whether or not they were held for trading. In query 2, the key point was that in accounting for deferred tax on revaluations of property, management's intentions to hold or dispose of the property are irrelevant. To gain marks in query 3 you had to stick to the point – discussing what should happen if a subsidiary has a different reporting date to its parent. Query 4 covered related parties. If you didn't spot this, go back and revise the definition of related parties – any question that involves the family of a director should raise in your mind the possibility of related parties being relevant to the answer.

Easy marks. If you had revised related parties, query 4 was pretty easy.

Examining team's comments. The examiner's report on this question twice commented that students wasted time discussing issues that were not asked for in the requirement. Ensure you read the requirements carefully and do not waste time talking about general requirements of standards that are not asked for.

[References: Conceptual Framework: para. 4.29; IFRS 9: paras. 4.1.1–4.1.5, 5.1.1–5.2.3, Appendix A; IFRS 10: paras. 19, B86–B93; IAS 12: paras. 5, 7, 15; IAS 24: paras. 8–9; IAS 33: para. 12]

Marking scheme

	Marks
Query One	
The accounting treatment of equity investments which we do not control or significantly influence is dealt with in IFRS 9 <i>Financial Instruments</i> .	½
Under IFRS 9, equity investments are financial assets which fail the ' contractual cash flow test '. Equity investments must be measured at fair value .	½ + ½
Under IFRS 9, gains or losses on the remeasurement of financial assets measured at fair value are normally taken to profit or loss.	½
In the case of equity investments not held for trading , it is possible to make an irrevocable election at initial recognition to recognise gains or losses on the remeasurement to fair value in other comprehensive income .	½ + ½ + ½
The IASB's <i>Conceptual Framework for Financial Reporting</i> makes no clear conceptual distinction between gains and losses reported in profit or loss and gains and losses reported in other comprehensive income.	½
The distinction between profit or loss and other comprehensive income does have some practical relevance, however.	½
The distinction is particularly important for listed entities. Such entities are required to report their earnings per share under IAS 33 <i>Earnings per Share</i> . Gains and losses reported in profit or loss affect earnings per share whereas gains or losses reported in other comprehensive income do not .	½ + ½ + ½
	<u>6</u>



	Marks
Query Two	
The difference between the \$64 million gain in the statement of comprehensive income and the \$80 million gain included in property, plant and equipment is caused by deferred tax.	1
IAS 12 <i>Income Taxes</i> requires that deferred tax liabilities are recognised (with a very few exceptions) on all taxable temporary differences.	1
A taxable temporary difference arises when the carrying value of an asset increases but its 'tax base' does not.	1
When an asset is revalued, the carrying value increases but the tax base stays the same (as the future tax deductions are unaffected).	1
Therefore a revaluation of \$80 million causes a taxable temporary difference of \$80 million and (when the tax rate is 20%) an additional deferred tax liability of \$16 million (\$80 million \times 20%).	1
This liability reduces the gain reported in the statement of comprehensive income to \$64 million (\$80 million – \$16 million).	<u>1</u>
	<u>6</u>
Query Three	
Under the provisions of IFRS 10 <i>Consolidated Financial Statements</i> the general rule is that the financial statements of all group members should have the same reporting date.	1
Where the reporting period of a subsidiary is different from the reporting period of the parent, that subsidiary should prepare, for consolidation purposes, additional financial information as of the same date as the financial statements of the parent.	1
Where it is 'impracticable' to prepare additional financial information, then the parent is permitted to consolidate the financial information of the subsidiary using the most recent financial information of the subsidiary 'adjusted for the effects of significant transactions or events in the intervening period'. 31 May 20X7 to 30 September 20X7 in this case.	1
For the above to be possible, the intervening period should be no longer than three months, so in this case additional interim financial information will have to be prepared.	<u>1</u>
	<u>4</u>
Query Four	
Under the provisions of IAS 24 <i>Related Party Disclosures</i> your son's business is a related party to Omega.	1
Your son's business is a related party because the business is controlled by your son, who is one of your 'close family members' and you are a part of Omega's 'key management'.	1
IAS 24 requires disclosure of all transactions with related parties irrespective of their size.	1
IAS 24 states that transactions with related parties are material by their nature.	<u>1</u>
	<u>4</u>
	<u>20</u>

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