Dip IFR

Diploma in International Financial Reporting

Friday 11 December 2015

Time allowed

Reading and planning: 15 minutes

Writing: 3 hours

ALL FOUR questions are compulsory and MUST be attempted.

Do NOT open this question paper until instructed by the supervisor.

During reading and planning time only the question paper may be annotated. You must NOT write in your answer booklet until instructed by the supervisor.

This question paper must not be removed from the examination hall.

The Association of Chartered Certified Accountants

ACCA

This is a blank page.
The question paper begins on page 3.

ALL FOUR questions are compulsory and MUST be attempted

1 Alpha's investments include two subsidiaries, Beta and Gamma. The draft statements of financial position of the three entities at 30 September 2015 were as follows:

	Alpha $'000	Beta $'000	Gamma $'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
	957,000	395,000	172,000
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
	190,000	151,000	125,000
Total assets	1,147,000	546,000	297,000
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	943,000	396,000	182,000
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	129,000	80,000	70,000
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	75,000	70,000	45,000
Total equity and liabilities	1,147,000	546,000	297,000

Note 1 – Alpha's investment in Beta

On 1 October 2012, Alpha acquired 300 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 2012, the market value of an Alpha share was $2·40. Alpha incurred directly attributable costs of $2 million on acquisition of Beta. These costs comprised:

– $0·8 million – cost of issuing own shares, debited to Alpha's share premium account within other components of equity;

– $1·2 million due diligence costs – included in the carrying amount of the investment in Beta in Alpha's own statement of financial position.

There has been no change to the carrying amount of this investment in Alpha's own statement of financial position since 1 October 2012.

On 1 October 2012, the individual financial statements of Beta showed the following reserves balances:

– Retained earnings $125 million.
– Other components of equity $10 million.

The directors of Alpha carried out a fair value exercise to measure the identifiable assets and liabilities of Beta at 1 October 2012. The following matters emerged:

– Plant and equipment having a carrying amount of $295 million had an estimated market value of $340 million. The estimated remaining useful economic life of this plant at 1 October 2012 was five years. None of this plant and equipment had been disposed of between 1 October 2012 and 30 September 2015.

– An in-process research and development project existed at 1 October 2012 but did not meet the recognition criteria of IAS 38 – *Intangible Assets*. The fair value of the research and development project at 1 October 2012 was $20 million. The project started to generate economic benefits on 1 October 2013 over an estimated period of four years.

The above two fair value adjustments have not been reflected in the individual financial statements of Beta. 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%.

Alpha uses the proportion of net assets method to calculate non-controlling interests in Beta.

Note 2 – Impairment review of goodwill on acquisition of Beta

No impairment of the goodwill on acquisition of Beta was evident when reviews were carried out on 30 September 2013 and 2014. On 30 September 2015, the directors of Alpha concluded that the recoverable amount of the net assets (including the goodwill) of Beta at that date was $450 million. Beta is regarded as a single cash generating unit for the purpose of measuring goodwill impairment.

Note 3 – Alpha's investment in Gamma

On 1 October 2014, Alpha acquired 144 million shares in Gamma by means of a cash payment of $125 million. Alpha incurred costs of $1 million 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 2015. There has been no change in the carrying amount of this investment in the financial statements of Alpha since 1 October 2014.

On 1 October 2014, the individual financial statements of Gamma showed the following reserves balances:

– Retained earnings $45 million.
– Other components of equity $2 million.

On 1 October 2014, 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 $100 million and a fair value of $130 million. This land continued to be an asset of Gamma at 30 September 2015. 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%.

There was no impairment of the goodwill arising on acquisition of Gamma in the consolidated financial statements at 30 September 2015.

Alpha uses the proportion of net assets method to calculate non-controlling interests in Gamma.

Note 4 – Other investments

Apart from its investments in Beta and Gamma, the investments of Alpha included in the statement of financial position at 30 September 2015 are all financial assets which Alpha measures at fair value though 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 Alpha and Gamma at 30 September 2015 included components purchased from Beta in the last three months of the financial year at a cost of $20 million to Alpha and $16 million to Gamma. Beta supplied these goods to both Alpha and Gamma at a mark-up of 25% on the cost to Beta.

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 2015, so at that date there were no outstanding intra-group balances.

Note 7 – Provision

On 30 September 2015, Alpha finalised the construction of an energy generating facility. The facility has an expected useful economic life of 25 years and Alpha has a legal requirement to decommission the facility at the end of its estimated useful life. The directors of Alpha estimated the costs of this decommissioning to be $34 million – based on prices prevailing at 30 September 2040. At an appropriate discount rate the present value of the cost of decommissioning the facility is $10 million. The directors of Alpha made a provision of $34 million and charged this amount as an operating cost in the financial statements of Alpha for the year ended 30 September 2015.

Note 8 – Long-term borrowings

On 1 October 2014, Alpha issued 40 million $1 bonds at par. The cost of issuing the bonds was $1 million and this cost was charged as a finance cost for the year ended 30 September 2015. 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 $40 million in the statement of financial position of Alpha at 30 September 2015.

Required:

(a) Prepare the consolidated statement of financial position of Alpha at 30 September 2015. You need only consider the deferred tax implications of any adjustments you make where the question specifically refers to deferred tax. (36 marks)

(b) On 15 November 2015, Alpha purchased shares in Theta which gave Alpha a 45% shareholding in Theta. On the same date, Alpha purchased an option which gave Alpha 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 2015 and 30 September 2017 at a price which makes it highly likely the option will be exercised during that period. The directors of Alpha are unsure how to treat Theta in the consolidated financial statements for the year ended 30 September 2016.

Required:

Advise the directors of Alpha on the appropriate treatment of Theta in the consolidated financial statements for the year ended 30 September 2016 PRIOR to any exercising of the option. (4 marks)

(40 marks)

2 Delta 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 2015 are shortly to be authorised for issue. The following events are relevant to these financial statements:

(a) On 1 October 2000, Delta purchased a large property for $20 million and immediately began to lease the property to Epsilon on an operating lease. Annual rentals were $2 million. On 30 September 2014, the fair value of the property was $26 million. Under the terms of the lease, Epsilon was able to cancel the lease by giving six months' notice in writing to Delta. Epsilon gave this notice on 30 September 2014 and vacated the property on 31 March 2015. On 31 March 2015, the fair value of the property was $29 million. On 1 April 2015, Delta immediately began to convert the property into ten separate flats of equal size which Delta intended to sell in the ordinary course of its business. Delta spent a total of $6 million on this conversion project between 31 March 2015 and 30 September 2015. The project was incomplete at 30 September 2015 and the directors of Delta estimate that they need to spend a further $4 million to complete the project, after which each flat could be sold for $5 million. Delta uses the fair value model to measure property whenever permitted by International Financial Reporting Standards. (9 marks)

(b) On 1 August 2015, Delta 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 2015. The asset was modified to suit Delta's purposes at a cost of $30,000 during August 2015 and brought into use on 1 September 2015. The directors of Delta 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 2015 – 2·5 groats to $1.
– 1 September 2015 – 2·4 groats to $1.
– 30 September 2015 – 2·0 groats to $1.
– 31 October 2015 – 2·1 groats to $1. (7 marks)

(c) On 1 October 2014, Delta granted share options to 100 senior executives. The options vest on 30 September 2017. The number of options granted per executive depend on the cumulative revenue for the three years ended 30 September 2017. Each executive will receive options as follows:

Cumulative revenue for the three years ended 30 September 2017	**Number of options PER EXECUTIVE**
Less than $180 million	Nil
At least $180 million but less than or equal to $270 million	200
More than $270 million	300

Delta's revenue for the year ended 30 September 2015 was $50 million. The directors of Delta have produced reliable budgets showing that the revenues of Delta for the next two years are likely to be:

– Year ended 30 September 2016 – $65 million.
– Year ended 30 September 2017 – $75 million.

On 1 October 2014, the fair value of these share options was $3 per option. This figure had increased to $3·60 per option by 30 September 2015 and was expected to be $5 per option by 30 September 2017. All of the 100 executives who were granted the options on 1 October 2014 were expected to remain as employees throughout the three-year period from 1 October 2014 to 30 September 2017. (4 marks)

Required:

Explain and show how the three events would be reported in the financial statements of Delta for the year ended 30 September 2015.

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

(20 marks)

3 **(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) Kappa prepares financial statements to 30 September each year. During the year ended 30 September 2015, Kappa entered into the following transactions:

(i) On 1 September 2015, Kappa sold a machine to a customer. Kappa also agreed to service the machine for a two-year period from 1 September 2015 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 2015.
- $810,000, if the customer paid by 31 January 2016.
- $820,000, if the customer paid by 28 February 2016.

The directors of Kappa consider that it is highly probable the customer will pay for the products in January 2016. The stand alone selling price of the machine was $700,000 and Kappa 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 2015, Kappa sold 100 identical items to a customer for $2,000 each. The items cost Kappa $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. Kappa 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 Kappa for the year ended 30 September 2015.

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

(20 marks)

4 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 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 2015 and the entity anticipates selling it by 31 December 2015. The year end of the entity is 30 September 2015. 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.

(20 marks)

End of Question Paper