
Answers

Marks

1 Consolidated statement of financial position of Alpha at 30 September 2016

Assets	\$'000	
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>	
Total assets	<u><u>1,700,530</u></u>	
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)
Total equity	<u><u>1,128,112</u></u>	
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)
Total non-current liabilities	<u><u>368,418</u></u>	
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
Total current liabilities	<u><u>204,000</u></u>	40
Total equity and liabilities	<u><u><u>1,700,530</u></u></u>	

WORKINGS – DO NOT DOUBLE COUNT MARKS. ALL NUMBERS IN \$'000 UNLESS OTHERWISE STATED:

Working 1 – Net assets table – Beta:

	1 October 2013 \$'000	30 September 2016 \$'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) x 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 x 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% x 54,000 (see above))	(10,800)		½	
Year end (20% x 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).				½
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

Working 2 – Net assets table – Gamma:

	1 October 2013 \$'000	30 September 2016 \$'000	For W3	For W6
Share capital	80,000	80,000	½	
Retained earnings:				
Land adjustment (70,000 – 50,000)	20,000	20,000	½	½
Deferred tax on fair value adjustment (20% x 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

Working 3 – Goodwill on consolidation

	Beta \$'000	Gamma \$'000	
Costs of investment:			
Shares issued to acquire Beta (40,000 x \$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% x 298,200 (W1)	59,640		1
Gamma – 20,000 x \$2.30		46,000	1
Net assets at date of acquisition (W1/W2)	<u>(298,200)</u>	<u>(171,000)</u>	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).

Marks**Working 4 – Impairment of Beta goodwill**

	\$'000	
Net assets of Beta as per working 1	353,600	1/2
Grossed up goodwill on acquisition (100/80 x 41,440)	<u>51,800</u>	1
	405,400	
Recoverable amount of Beta as a CGU	(400,000)	1/2
So gross impairment equals	<u>5,400</u>	1/2
80% thereof equals	<u>4,320</u>	1/2
		<u>3</u>
		⇒W3

Working 5 – Non-controlling interest

	Beta \$'000	Gamma \$'000	
At date of acquisition (W3)	59,640	46,000	1/2 + 1/2
Share of post-acquisition increase in net assets per workings 1 and 2:			
Beta – 20% x 55,400 (W1)	11,080		1/2
Gamma – 25% x 15,000 (W2)		<u>3,750</u>	1/2
	<u>70,720</u>	<u>49,750</u>	<u>2</u>

The total NCI is 120,470 (70,720 + 49,750).

Working 6 – Retained earnings

	\$'000	
Alpha	573,000	1/2
Adjustment for acquisition costs	(3,000)	1/2
Adjustment for increase in contingent consideration re: Gamma (24,000 – 20,000)	(4,000)	1/2
Adjustment for restoration provision (W8)	392	3 (W8)
Beta (80% x 50,400 (W1))	40,320	1/2 + 5 (W1)
Gamma (75% x (15,000 (W2))	11,250	1/2 + 2 (W2)
Impairment of Beta goodwill (W4)	<u>(4,320)</u>	1/2
	<u>613,642</u>	<u>13</u>

Working 7 – Other components of equity

	\$'000	
Alpha – per own financial statements	250,000	1/2
Beta (80% x 5,000 (W1))	<u>4,000</u>	1/2
	<u>254,000</u>	<u>1</u>

Working 8 – Adjustment re: restoration provision

	\$'000	
Originally required provision (25,000 x 0.312)	<u>7,800</u>	1
One year's unwinding of discount (7,800 x 6%)	(468)	1/2
One year's depreciation of capitalised cost (7,800 x 1/20)	(390)	1
Original provision incorrectly made	<u>1,250</u>	1/2
So retained earnings adjustment equals	<u>392</u>	<u>3</u>
		⇒W6

Working 9 – Deferred tax

	\$'000	
Alpha + Beta + Gamma	103,000	1/2
On fair value adjustments in Beta (W1)	8,400	1/2
On fair value adjustments in Gamma (W2)	<u>4,000</u>	1/2
	<u>115,400</u>	<u>1 1/2</u>

2 (a) All numbers in \$'000 unless otherwise stated

The lease of the asset by Delta to Epsilon would be regarded as a **finance lease** because the **risks and rewards of ownership** have been transferred to Epsilon. Evidence of this includes **the lease is for the whole of the life of the asset** and Epsilon being responsible for repairs and maintenance.

½ + ½ + ½

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 x 7.247 which (subject to rounding) equals 20,200**.

½ + 1

[NB: 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 2016 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:

Year to 30 September	Balance b/fwd	Rental	Balance in period	Finance income	Balance c/fwd
2015	20,200	(2,787)	17,413	1,393	18,806
2016	18,806	(2,787)	16,019	1,282	17,301
2017	17,301	(2,787)	14,514		

1½

1

½

During the year ended 30 September 2016, Delta will recognise income from finance leases of **1,282**.

½

The net investment on 30 September 2016 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 2016 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 2016 will be **460,000** (500,000 x 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

(c) In accordance with IFRS 2 – *Share Based Payments* – 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**.

½ + ½

The liability should be built up **over the vesting period** based on the estimated number of rights **ultimately estimated to vest**.

½ + ½

The liability at 30 September 2015 would have been \$26,250 [1/3 (250 x 90 x \$3.50)].

1

The liability at 30 September 2016 would have increased to \$52,800 [2/3 (250 x 88 x \$3.60)]. This will be shown as a non-current liability.

1

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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 2016.

1
5
20

3 (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

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.

1

8

(b) (i) The loan is a financial asset which would initially be recognised at its fair value on 1 October 2015.

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 2015.

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** ($\$661,157 \times 10\%$) will be recognised as finance income in the year ended 30 September 2016. 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 2017.

½ + ½ + ½

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 \text{ 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.

½

4

(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 2015 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.

1320

4 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.

 $\frac{1}{2} + \frac{1}{2}$

IAS 24 – *Related Party Disclosures* – 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.

 $\frac{1}{2} + \frac{1}{2}$

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.

15

Query Two

The accounting treatment of the majority of tangible non-current assets is governed by IAS 16 – *Property, Plant and Equipment* (PPE).

 $\frac{1}{2}$

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.

 $\frac{1}{2}$

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.

 $\frac{1}{2} + \frac{1}{2} + \frac{1}{2}$

Properties which are held for investment purposes are **not** accounted for under IAS 16, but under IAS 40 – *Investment Property*.

 $\frac{1}{2}$

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.

17

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Query Three

Accounting for product design costs is governed by IAS 38 – *Intangible Assets*.

1/2

Under IAS 38, the treatment of expenditure on intangible items depends on how it arose.

1/2

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 2016 and expenditure after that date.

1/2 + 1/2 + 1/2

1/2 + 1/2 + 1/2

5

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**.

1/2 + 1/2

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.

1

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