Diploma in International Financial Reporting

Tuesday 9 June 2015

Time allowed
Reading and planning: 15 minutes
Writing: 3 hours

ALL FOUR questions are compulsory and MUST be attempted.

Do NOT open this 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

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The question paper begins on page 3.

ALL FOUR questions are compulsory and MUST be attempted

1 Alpha holds investments in two other entities, Beta and Gamma. The draft statements of financial position of the three entities at 31 March 2015 were as follows:

	Alpha $'000	Beta $'000	Gamma $'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)	267,000	40,000	10,000
	567,000	280,000	190,000
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	15,000	10,000	8,000
	177,000	116,000	93,000
Total assets	744,000	396,000	283,000
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)	5,000	4,000	2,000
Total equity	572,500	269,000	173,000
Non-current liabilities:			
Provision (Note 6)	12,500	Nil	Nil
Long-term borrowings (Note 7)	60,000	45,000	50,000
Deferred tax	32,000	30,000	20,000
Total non-current liabilities	104,500	75,000	70,000
Current liabilities:			
Trade and other payables (Note 5)	45,000	42,000	33,000
Short term borrowings	22,000	10,000	7,000
Total current liabilities	67,000	52,000	40,000
Total equity and liabilities	744,000	396,000	283,000

Note 1 – Alpha's investment in Beta

On 1 April 2010, Alpha acquired 120 million shares in Beta by means of a cash payment of $234·5 million. Alpha also incurred directly attributable costs of $2·5 million associated with the acquisition of Beta and recognised the investment in its individual statement of financial position at $237 million. There has been no change to the carrying value of this investment in Alpha's own statement of financial position since 1 April 2010.

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 2010 can be used for this purpose. On 1 April 2010, the market value of a Beta share was $1·80.

On 1 April 2010, the individual financial statements of Beta showed the following reserves balances:

– Retained earnings $75 million.
– Other components of equity $1 million.

The directors of Alpha carried out a fair value exercise to measure the identifiable assets and liabilities of Beta at 1 April 2010. The following matters emerged:

– Property having a carrying value of $150 million at 1 April 2010 (depreciable component $80 million) had an estimated market value of $180 million at that date (depreciable component $90 million). The estimated future economic life of the depreciable component at 1 April 2010 was 20 years. This property is included in Beta's statement of financial position at 31 March 2015.
– Plant and equipment having a carrying value of $110 million at 1 April 2010 had an estimated market value of $123 million at that date. Beta has disposed of all of this plant and equipment since 1 April 2010.

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 2010.

Note 2 – Alpha's investment in Gamma

On 1 July 2014, 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 2014, 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 $1·5 million 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 2015.

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

– Retained earnings $45 million. The profits of Gamma for the year ended 31 March 2015 accrued evenly over the year.
– Other components of equity $2 million. See also the information provided in note 3 regarding other components of equity.

Gamma leases all of its properties on operating leases and its plant and equipment comprises assets with relatively short useful economic lives. Therefore on 1 July 2014, 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 2014.

Note 3 – Other investments

Apart from its investment in Beta, the investments of Alpha included in the statement of financial position at 31 March 2015 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 2015. The fair values which are included in the draft statements of financial position above are the fair values at 31 March 2014 for Beta and 1 July 2014 for Gamma. Relevant fair values as at 31 March 2015 were as follows:

– Alpha – $33 million.
– Beta – $43 million.
– Gamma – $11·6 million. The change in the fair value of Gamma's investments during the year ended 31 March 2015 was caused by events occurring AFTER 1 July 2014.

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 2015 included components purchased from Alpha in the last three months of the financial year at a cost of $15 million to Beta and $10 million 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 $9 million receivable from Beta and $6 million receivable from Gamma in respect of the purchase of components (see Note 4). On 30 March 2015, Beta and Gamma paid $9 million and $6 million respectively to Alpha and so eliminated their trade payables balance in respect of the purchase of components. Alpha recorded these receipts on 3 April 2015.

Note 6 – Provision

On 1 March 2015, the board of directors of Alpha finalised a plan to re-organise and reconstruct the group. The plan was publicly announced on 15 March 2015. 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:

	$ million
Redundancy costs	8
Costs of relocating employees to new locations	2·5
Costs of retraining existing employees for work at new locations	2·0
	12·5

On 15 March 2015, the property, plant and equipment of unit X, which is included in the above statement of financial position, had a total carrying value of $15 million. $12 million of this amount relates to property, and $3 million to plant and equipment. On 15 March 2015, all of the property, plant and equipment was offered for sale. The property was offered for sale at a price of $16·5 million, and the plant and equipment at $1·05 million. 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 2015. You can assume that any change in carrying value of this property, plant and equipment between 15 and 31 March 2015 is immaterial.

Note 7 – Long-term borrowings

On 31 March 2015, 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 2020. As an alternative to redemption, the loan note holders can elect to exchange their loan notes for equity shares in Alpha on 31 March 2020. 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 2015, Alpha debited cash and credited long-term borrowings with $30 million in respect of this loan.

Required:

Prepare the consolidated statement of financial position of Alpha at 31 March 2015.

(40 marks)

2 Delta is an entity which prepares financial statements to 31 March each year. The financial statements for the year ended 31 March 2015 are to be authorised for issue on 30 June 2015. The following events are relevant to these financial statements:

(a) On 1 April 2014, 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 2014. On 31 December 2014, 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 2014 and 31 March 2015. On 31 March 2015, the market value of a share in Epsilon was $2·90. (9 marks)

(b) On 1 April 2014, Delta sold a property for $48 million to raise cash to expand its business. The carrying value of the property on 1 April 2014 was $50 million and its fair value was $55 million. The estimated future useful life of the property on 1 April 2014 was 40 years. On 1 April 2014, Delta began to lease this property on a 10 year lease. The annual lease rentals for the first five years of the lease were set at $1 million. For the final five years of the lease, the rentals were set at $1·5 million. Both of these rental amounts were below the market rental for a property of this nature. (7 marks)

(c) On 31 March 2015, the inventories of Delta included a consignment of components which Delta had been supplying to a number of different customers for some years. The cost of the consignment was $10 million and based on retail prices at 31 March 2015, the expected selling price of the consignment would have been $12 million. On 15 May 2015, a competitor completed the development of an alternative component which seems likely to make Delta's consignment obsolete. The directors of Delta estimate that the consignment (all still currently unsold) will now be sold for only $2 million. (4 marks)

Required:

Explain and show how the three events should be reported in the financial statements of Delta for the year ended 31 March 2015.

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

(20 marks)

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Question 3 begins on page 8.

3 (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 2015:

(i) On 1 April 2013, Kappa granted options to 500 employees to subscribe for 400 shares each in Kappa on 31 March 2017, providing the employees still worked for Kappa at that time. On 1 April 2013, the fair value of each option was $1·50.

In the year ended 31 March 2014, ten of these employees left Kappa and at 31 March 2014, Kappa expected that 20 more would leave in the three-year period from 1 April 2014 to 31 March 2017. Kappa's results for the year ended 31 March 2014 were below expectations and at 31 March 2014 the fair value of each option had fallen to 25 cents. Therefore, on 1 April 2014 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 2015, five of the employees left and at 31 March 2015, Kappa expected that ten more would leave in the two-year period from 1 April 2015 to 31 March 2017. The results of Kappa for the year ended 31 March 2015 were much improved and at 31 March 2015, the fair value of a re-priced option was $1·60. (9 marks)

(ii) On 1 April 2013, 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 2016:

– 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 $1 million.
– 2,000 rights per employee are awarded if the cumulative profit for the three-year period exceeds $1 million.

On 1 April 2013, 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 2014, this estimate was revised at that time to $450,000. However, given the improvement in results for the year ended 31 March 2015, the estimate was revised again at 31 March 2015 to $1,100,000.

On 1 April 2013, the fair value of one share appreciation right was $1·10. This estimate was revised to $0·90 at 31 March 2014 and to $1·20 at 31 March 2015. All the senior employees are expected to remain employed by Kappa for the relevant three-year period. The rights are exercisable on 30 June 2016.
(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 2015.

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

Ignore deferred tax.

(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 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.

(20 marks)

End of Question Paper