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# Answers

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		<i>Marks</i>
<b>1</b>	<b>Consolidated statement of financial position of Alpha at 30 September 2013</b>	
	<b>ASSETS</b>	<b>\$'000</b>
	<b>Non-current assets:</b>	
	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)
		<hr/> 782,366
	<b>Current assets:</b>	
	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
		<hr/> 274,600
	<b>Total assets</b>	<hr/> <u>1,056,966</u>
	<b>EQUITY AND LIABILITIES</b>	
	<b>Equity attributable to equity holders of the parent</b>	
	Share capital	195,000      ½
	Retained earnings (W4)	147,232      11½ (W4)
	Other components of equity (W5)	194,324      3½ (W5)
		<hr/> 536,556
	Non-controlling interest (W3)	53,200      1 (W3)
	<b>Total equity</b>	<hr/> 589,756
	<b>Non-current liabilities:</b>	
	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)
	Deferred tax (50,000 + 35,000 – 1,500 (Note 3) + 2,900 (W12))	86,400      ½ + 1 + ½
	<b>Total non-current liabilities</b>	<hr/> 355,210
	<b>Current liabilities:</b>	
	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
	<b>Total current liabilities</b>	<hr/> 112,000 <b>40</b>
	<b>Total equity and liabilities</b>	<hr/> <u>1,056,966</u>

WORKINGS –DO NOT DOUBLE COUNT MARKS. ALL NUMBERS IN \$'000 UNLESS OTHERWISE STATED. NB: ALPHA OWNS 80% OF THE SHARES IN BETA AND 40% OF THE SHARES IN GAMMA

Working 1 – Net assets table – Beta:

	1 July 2012 \$'000	30 September 2013 \$'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 x 15/48)		(2,500)		½
Intangible asset adjustment	12,000	12,000	½	
Extra amortisation (12,000 x 15/60))		(3,000)		½
Deferred tax on fair value adjustments	(4,400)	(2,900)	1½	1½
			(W12)	(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

	½
	<u>4½</u>
⇒W2	⇒W4

Working 2 – Goodwill on consolidation (Beta)

	\$'000	
Cost of investment:		
Share exchange (120 million x 5/6 x \$2.40)	240,000	1
Deferred consideration (50 million)/1·10 <sup>3</sup>	37,566	1
Fair value of non-controlling interest at date of acquisition (30 million x \$1.70)	<u>51,000</u>	1
	328,566	
Net assets at 1 April 2012 (W1)	(210,600)	4½ (W1)
Goodwill	<u>117,966</u>	<u>7½</u>

Working 3 – Non-controlling interest in Beta

	\$'000	
Fair value at date of acquisition (W2)	51,000	½
20% of post-acquisition increase in net assets (11,000 (W1))	<u>2,200</u>	½
	<u>53,200</u>	<u>1</u>

Working 4 – Retained earnings

	\$'000	
Alpha	185,000	½
Finance costs on deferred consideration (939 (W8) + 3,851 (W8))	(4,790)	½ + ½
Adjustment for intangible asset (W7)	(35,000)	½
Adjustment for finance cost of loan (W9)	(5,678)	½
Beta (80% x 11,000 (W1))	8,800	½ + 5½ (W1)
Gamma (40% x (75,000 – 66,000))	3,600	½ + ½
Unrealised profits on sales to Beta (14,000 x 1/4)	(3,500)	1
Unrealised profits on sales to Gamma (12,000 x 1/4 x 40%)	<u>(1,200)</u>	<u>1</u>
	<u>147,232</u>	<u>11½</u>

Working 5 – Other components of equity – Alpha

	\$'000	
Alpha	192,000	½
Deduct gain on revaluation of investment in Gamma	(2,000)	1
Gain on fair value of hedge accounted derivative	1,100	½
Equity component of convertible loan (W10)	<u>3,224</u>	<u>1½ (W10)</u>
	<u>194,324</u>	<u>3½</u>

**Marks**

**Working 6 – Property, plant and equipment**

	<b>\$'000</b>	
Alpha + Beta	555,000	½
Reversal of post-acquisition revaluation – Beta	(7,500)	½
Fair value adjustment – Beta (8,000 – 2,500 – W1)	5,500	½
	<u>553,000</u>	<u>1½</u>

**Working 7 – Intangible assets**

	<b>\$'000</b>	
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>

**Working 8 – Deferred consideration**

	<b>\$'000</b>	
At 1 July 2012 (W1)	37,566	½
Finance cost to 30 September 2012 (10% x 3/12)	939	½
At 1 October 2012	38,505	
Finance cost to 30 September 2013 (10%)	3,851	½
At 30 September 2013	<u>42,356</u>	<u>1½</u>

**Working 9 – Convertible loan**

	<b>\$'000</b>	
Initial carrying amount (75,600 x 0.751)	56,776	1
Finance cost to 30 September 2013 (10% x 56,776)	5,678	½
At 30 September 2013	<u>62,454</u>	<u>1½</u>

**Working 10 – Equity component of convertible loan**

	<b>\$'000</b>	
Carrying amount is balancing figure (60,000 – 56,776 (W9))	<u>3,224</u>	<u>1</u>
		⇒W5

**Working 11 – Investment in Gamma**

	<b>\$'000</b>	
Cost	80,000	½
Share of post-acquisition profits (W4)	3,600	½
Unrealised profit (W4)	(1,200)	½
	<u>82,400</u>	<u>1½</u>

**Working 12 – Deferred tax on fair value adjustments**

**Fair value adjustments:**

	<b>1 July 2012 \$'000</b>	<b>30 September 2013 \$'000</b>	
Plant and equipment adjustment	10,000	5,500	1
Intangible asset adjustment	12,000	9,000	1
Net taxable temporary differences	<u>22,000</u>	<u>14,500</u>	
Related deferred tax (20%)	4,400	2,900	1
			<u>3</u>
			⇒W1

		<b>Marks</b>
<b>2 (a)</b>	IFRS 9 – <i>Financial Instruments</i> – requires entities to measure financial assets 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
	In this case, amortised cost should be used because Delta’s objective is to hold the assets to collect the contractual cash flows associated with it and those cash flows consist solely of the repayment of principal and interest by Epsilon.	1
	The asset will initially be measured at \$36 million (\$40 million x 90 cents).	½
	The finance income for the six months to 30 September 2013 will be \$1.782 million (\$36 million x 9.9% x 6/12).	1
	The closing asset will be \$37.782 million (\$36 million + \$1.782 million).	½
	This asset will be split into its current and non-current portions.	½
	The interest payment due on 31 March 2014 of \$1.6 million (\$40 million x 4%) will be a current asset.	1
	The remaining asset of \$36.182 million (\$37.782 million – \$1.6 million) will be non-current.	½
	The information regarding the financial difficulty of Epsilon is an event after the reporting period.	½
	It is a non-adjusting event as it gives evidence of conditions arising after the end of the reporting period.	½
	Therefore the financial statements are not adjusted but Delta should disclose the nature of the event and an estimate of its financial effect as non-disclosure could influence the economic decisions users of the financial statements might make.	1
		<b>8</b>
<b>(b)</b>	The business would be regarded as held for sale from 1 June 2013. The held for sale criteria apply because the business 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 classification, IFRS 5 – <i>Non-current Assets Held for Sale and Discontinued Operations</i> – requires that the assets be separately classified under current assets in the statement of financial position. No further depreciation would be charged on these assets.	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, the total carrying amount after re-measurement will be \$46 million (\$46.5 million – \$0.5 million).	1
	The impairment loss of \$17 million (\$63 million – \$46 million) 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 since their recoverable amounts are at least equal to their existing carrying amounts.	1
	The remaining impairment loss of \$7 million (\$17 million – \$10 million) 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 \$15 million and \$6 million respectively.	1
		<b>7</b>
<b>(c)</b>	Because the lease-back is a five-year lease of a property with a useful economic life of 25 years, the lease will be considered to be an operating lease.	½
	Therefore the property will be removed from property, plant and equipment.	½
	Because the property is being leased at a rental which is lower than market rentals, the apparent loss on sale of \$3 million (\$23 million – \$20 million) will be recognised over the lease term.	½
	Therefore, in the year ended 30 September 2013, a loss on sale of \$300,000 (\$3 million x 6/60) will be recognised in profit or loss.	1
	The unrecognised loss on sale of \$2.7 million (\$3 million – \$300,000) will be shown as a deferred expense.	½
	\$600,000 (\$3 million x 12/60) of the above will be shown as a current asset and the balance of \$2.1 million (\$2.7 million – \$600,000) as a non-current asset.	1
	A rental expense of \$900,000 (\$1.8 million x 6/12) will be recognised in profit or loss for the year ended 30 September 2013.	½
	A pre-payment of \$900,000 will be shown in current assets at 30 September 2013.	½
		<b>5</b>
		<b>20</b>

<p><b>3 (a)</b> The tax base of an asset is the amount which will be <b>deductible</b> for tax purposes against any <b>taxable economic benefits</b> which will flow to the entity when the asset is recovered. If these benefits are <b>not taxable, the tax base equals the carrying amount.</b></p> <p>The tax base of a liability is its <b>carrying amount</b>, less any amount which will be <b>deductible for tax purposes</b> in respect of that liability in future periods. If the 'liability' is revenue received in advance, the tax base is its <b>carrying amount, less any revenue which will not be taxable in future periods.</b></p> <p>The general requirements of IAS 12 are that deferred tax liabilities should be recognised on all taxable temporary differences.</p> <p>IAS 12 states that a deferred tax asset <b>should</b> be recognised for deductible temporary differences if it is <b>probable</b> that taxable profit will arise in future <b>against which the deductible temporary difference can be utilised.</b></p>	<p><math>\frac{1}{2} + \frac{1}{2} + \frac{1}{2}</math></p> <p><math>\frac{1}{2} + \frac{1}{2} + 1</math></p> <p><math>\frac{1}{2}</math></p> <p><math>\frac{1}{2} + \frac{1}{2}</math></p> <hr style="width: 10%; margin-left: auto; margin-right: 0;"/> <p><b>5</b></p>
<p><b>(b) (i)</b> Because the unrealised gain on revaluation of the equity investment is not taxable until sold, there are no current tax consequences.</p> <p>Because the unrealised gain on revaluation of the equity investment is not taxable until sold, the tax base of the investment is \$200,000.</p> <p>The revaluation creates a <b>taxable</b> temporary difference of <b>\$40,000</b> (\$240,000 – \$200,000).</p> <p>This creates a deferred tax liability of <b>\$10,000</b> (\$40,000 x 25%). The liability would be <b>non-current</b>. The fact that there is no intention to dispose of the investment <b>does not affect the accounting treatment.</b></p> <p><b>Because</b> the unrealised gain is reported in other comprehensive income, the related deferred tax expense is also reported in <b>other comprehensive income.</b></p>	<p><math>\frac{1}{2}</math></p> <p>1</p> <p><math>\frac{1}{2} + \frac{1}{2}</math></p> <p><math>\frac{1}{2} + \frac{1}{2} + \frac{1}{2}</math></p> <p><math>\frac{1}{2} + \frac{1}{2}</math></p> <hr style="width: 10%; margin-left: auto; margin-right: 0;"/> <p><b>5</b></p>
<p><b>(ii)</b> When Kappa sold the products to Omega, Kappa would have generated a taxable profit of <b>\$16,000</b> (\$80,000 – \$64,000). This would have created a current tax liability for Kappa and the group of <b>\$4,000</b> (\$16,000 x 25%). This liability would be shown as a <b>current</b> liability and charged as an expense in arriving at <b>profit or loss for the period.</b></p> <p>In the consolidated financial statements the carrying value of the unsold inventory would be <b>\$38,400</b> (\$64,000 x 60%). The tax base of the unsold inventory would be <b>\$48,000</b> (\$80,000 x 60%).</p> <p>In the consolidated financial statements there would be a <b>deductible</b> temporary difference of <b>\$9,600</b> (\$38,400 – \$48,000) and a potential deferred tax asset of <b>\$2,400</b> (\$9,600 x 25%). This would be recognised as a deferred tax <b>asset</b> since Omega is expected to generate <b>sufficient taxable profits</b> against which to utilise the deductible temporary difference.</p> <p>The deferred tax asset would be recognised as a current asset. The resulting credit would <b>reduce consolidated deferred tax expense</b> in arriving at profit or loss.</p>	<p><math>\frac{1}{2} + \frac{1}{2} + \frac{1}{2} + \frac{1}{2}</math></p> <p><math>\frac{1}{2} + \frac{1}{2}</math></p> <p><math>\frac{1}{2} + \frac{1}{2} + \frac{1}{2} + \frac{1}{2}</math></p> <p><math>\frac{1}{2} + \frac{1}{2}</math></p> <hr style="width: 10%; margin-left: auto; margin-right: 0;"/> <p><b>6</b></p>
<p><b>(iii)</b> The receipt of revenue in advance on 31 March 2013 would create a <b>current</b> tax liability of <b>\$50,000</b> (\$200,000 x 25%) as at 30 September 2013.</p> <p>The carrying value of the revenue received in advance at 30 September 2013 is <b>\$80,000</b> (\$200,000 – \$120,000). Its tax base is nil (\$80,000 – \$80,000).</p> <p>The deductible temporary difference of \$80,000 would create a deferred tax <b>asset</b> of <b>\$20,000</b> (\$80,000 x 25%). The asset can be recognised because Kappa has <b>sufficient taxable profits</b> against which to utilise the deductible temporary difference. It would be recognised as a <b>current</b> asset since the remaining revenue is recognised in the following accounting period.</p>	<p><math>\frac{1}{2} + \frac{1}{2}</math></p> <p><math>\frac{1}{2} + \frac{1}{2}</math></p> <p><math>\frac{1}{2} + \frac{1}{2} + \frac{1}{2} + \frac{1}{2}</math></p> <hr style="width: 10%; margin-left: auto; margin-right: 0;"/> <p><b>4</b></p> <hr style="width: 10%; margin-left: auto; margin-right: 0;"/> <p><b>20</b></p>

## 4 (a) Computation of the cost of the factory

Description	Included in PPE \$'000	Explanation	
Purchase of land	10,000	<b>Both</b> the purchase of the land and the associated legal costs are <b>direct</b> costs of constructing the factory	1
Preparation and levelling	300	A direct cost of constructing the factory	1/2
Materials	6,080	A direct cost of constructing the factory	1/2
Employment costs of construction workers	1,400	A direct cost of constructing the factory for a <b>seven-month</b> period	1/2
Direct overhead costs	700	A direct cost of constructing the factory for a <b>seven-month</b> period	1/2
Allocated overhead costs	Nil	Not a direct cost of construction	1/2
Income from use as a car park	Nil	Not essential to the construction so recognised directly in profit or loss	1
Relocation costs	Nil	Not a direct cost of construction	1/2
Opening ceremony	Nil	Not a direct cost of construction	1/2
Finance costs	700	Capitalise the interest cost incurred in an <b>eight-month</b> period (purchase of land would trigger off capitalisation)	1 1/2
Investment income on temporary investment of the loan proceeds	(100)	Must offset against the amount capitalised	1/2
Demolition cost recognised as a provision	920	Where an obligation must recognise as part of the initial cost	1
<b>Total</b>	<u>20,000</u>		1/2
<b>Computation of accumulated depreciation</b>			
Total depreciable amount	<u>10,000</u>	All of the net finance cost of 600 (700 – 100) has been allocated to the depreciable amount. Also acceptable to reduce by allocating a portion to the non-depreciable land element	1
Depreciation must be in two parts		Principle	1/2
Depreciation of roof component	50	$10,000 \times 30\% \times 1/20 \times 4/12$	1 1/2
Depreciation of remainder	<u>58</u>	$10,000 \times 70\% \times 1/40 \times 4/12$	1
Total depreciation	<u>108</u>		1/2
<b>Computation of carrying amount</b>			
	<u>19,892</u>	20,000 – 108	1/2
			<u>14</u>

## (b) Amount included in statement of financial position at 30 September 2013

	Amount	Explanation	
Number of executives	190	Use <b>expected number based on latest estimates</b> as a <b>non-market</b> vesting condition	1/2 + 1/2
Options vesting for each executive	2,000	Use <b>expected number based on latest estimates</b> as a <b>non-market</b> vesting condition	1/2
Impact of expected share price	None	This is a <b>market-based</b> vesting condition and is <b>ignored</b> for this purpose	1/2
Fair value of option	\$0.50	Use <b>fair value on grant date</b> per IFRS 2	1/2
Proportion vesting	2/3	Two years through a three-year vesting period	1/2
Included in equity	\$126,667	$190 \times 2,000 \times \$0.50 \times 2/3$	1
<b>Amount included in statement of profit or loss and other comprehensive income for the year ended 30 September 2013</b>			
Cumulative amount recognised in equity at 30 September 2013 (see above)	\$126,667		1/2
Amount recognised in previous year	\$(50,000)	$200 \times 1,500 \times \$0.50 \times 1/3$	1
So included in current year's profit or loss	<u>\$76,667</u>		1/2
			<u>6</u>
			<u>20</u>