1 Consolidated statement of financial position of Alpha at 30 September 20X7
(Note: All figures below in $'000)

Assets
Non-current assets:
Property, plant and equipment (966,500 + 546,000 + 35,000 (W1)) 1,547,500 ½ + ½
Goodwill (W2) 62,000 3½ (W2)
Intangible assets (20,000 + 10,000 (W1)) 30,000 ½ + ½

Total non-current assets 1,639,500

Current assets:
Inventories (165,000 + 92,000 – (30,000 x 1/3 x 25/125%)) 255,000 ½ + 1
Trade receivables (99,000 + 76,000) 175,000 ½
Cash and cash equivalents (18,000 + 16,000) 34,000 ½

Total current assets 464,000

Total assets 2,103,500

Equity and liabilities
Equity attributable to equity holders of the parent
Share capital ($1 shares) 360,000 ½
Retained earnings (W4) 571,310 7 (W4)
Other components of equity (W8) 113,380 4 (W8)

Total equity 1,044,690

Non-controlling interest (W3) 156,000 1 (W3)

Total equity and liabilities 2,103,500

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

Working 1 – Net assets table for Beta

<table>
<thead>
<tr>
<th></th>
<th>1 April 20X7</th>
<th>30 September 20X7</th>
<th>For W2</th>
<th>For W4</th>
</tr>
</thead>
<tbody>
<tr>
<td>Share capital</td>
<td>160,000</td>
<td>160,000</td>
<td>½</td>
<td></td>
</tr>
<tr>
<td>Retained earnings:</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Per financial statements of Beta</td>
<td>340,000</td>
<td>360,000</td>
<td>½</td>
<td>½</td>
</tr>
<tr>
<td>Fair value adjustments:</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Plant and equipment</td>
<td>40,000</td>
<td>35,000</td>
<td>½</td>
<td>1</td>
</tr>
<tr>
<td>Development project</td>
<td>10,000</td>
<td>10,000</td>
<td>½</td>
<td>½</td>
</tr>
<tr>
<td>Deferred tax on fair value adjustments:</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Date of acquisition (20% x (40,000 + 10,000))</td>
<td>(10,000)</td>
<td></td>
<td>½</td>
<td></td>
</tr>
<tr>
<td>Year end (20% x (35,000 + 10,000))</td>
<td></td>
<td>(9,000)</td>
<td></td>
<td>½</td>
</tr>
<tr>
<td>Net assets for the consolidation</td>
<td>540,000</td>
<td>556,000</td>
<td>2½</td>
<td>2½</td>
</tr>
</tbody>
</table>

Increase in net assets post-acquisition (556,000 – 540,000) 16,000

⇒ W2
⇒ W4
Working 2 – Goodwill on acquisition of Beta

Cost of investment:  
Cash paid  
Non-controlling interest at date of acquisition (40,000 x $3.80)  
Net assets at date of acquisition (W1)  

\[ \begin{align*} 
\text{\$'000} & \quad \frac{1}{2} \\
450,000 & \quad \frac{1}{2} \\
152,000 & \quad \frac{1}{2} \\
(540,000) & \quad 2\frac{1}{2} (W1) \\
\hline 
62,000 & \quad 3\frac{1}{2} \\
\end{align*} \]

Working 3 – Non-controlling interest in Beta

At date of acquisition (W2)  
25% of post-acquisition increase in net assets of 16,000 (W1)  

\[ \begin{align*} 
\text{\$'000} & \quad \frac{1}{2} \\
152,000 & \quad \frac{1}{2} \\
4,000 & \quad \frac{1}{2} \\
\hline 
156,000 & \quad 1 \\
\end{align*} \]

Working 4 – Retained earnings

\[ \begin{align*} 
\text{\$'000} & \quad \frac{1}{2} \\
\text{Alpha – per draft SOFP} & \quad \frac{1}{2} \\
\text{Adjustment for unrealised profit on unsold inventory (2,000 less 20% (deferred tax))} & \quad 1 (W6) \\
\text{Adjustment for finance cost of loan (W6)} & \quad 2 (W7) \\
\text{Beta – 75% x 16,000 (W1)} & \quad 3\frac{1}{2} (W1) \\
\hline 
571,310 & \quad 7 \\
\end{align*} \]

Working 5 – Equity component of long-term loan

Total proceeds of compound instrument  
Debt component:  
\begin{align*} 
\text{Interest stream} & \quad 300,000 \times 6\% \times 3.99 \quad \frac{1}{2} \\
\text{Principal repayment} & \quad 300,000 \times 0.681 \quad \frac{1}{2} \\
\hline 
\text{So equity component equals} & \quad 23,880 \quad 1\frac{1}{2} \\
\end{align*} 

Working 6 – Adjustment for finance cost of loan

Actual finance cost – 8% (300,000 – 23,880 (W5))  
Incorrectly charged by Alpha (300,000 x 6%)  

\[ \begin{align*} 
\text{\$'000} & \quad \frac{1}{2} \\
22,090 & \quad \frac{1}{2} \\
(18,000) & \quad 1 \\
\hline 
4,090 & \quad 1 \\
\end{align*} \]

Working 7 – Adjustment re: defined benefit retirement benefit plan

\[ \begin{align*} 
\text{\$'000} & \quad \frac{1}{2} \\
\text{Current service cost} & \quad \frac{1}{2} \\
\text{Interest cost (8\% x 187,500)} & \quad 1 \\
\text{Contributions incorrectly charged to profit or loss} & \quad 2 \\
\hline 
5,000 & \quad 2 \\
\end{align*} \]

Working 8 – Other components of equity

\[ \begin{align*} 
\text{\$'000} & \quad \frac{1}{2} \\
\text{Alpha – per draft financial statements} & \quad \frac{1}{2} \\
\text{Equity element of convertible loan (W5)} & \quad 1\frac{1}{2} \\
\text{Actuarial gain/(loss) on defined benefit retirement benefits plan (W9)} & \quad 2 \\
\hline 
113,380 & \quad 4 \\
\end{align*} \]
Working 9 – Actuarial gain/(loss) on defined benefit pension plan

\[\begin{align*}
\text{Opening liability} & \quad 187,500 \\
\text{Current service cost} & \quad 60,000 \\
\text{Interest cost (principle mark already awarded)} & \quad 15,000 \\
\text{Contributions paid into plan} & \quad (70,000) \\
\hline
& \quad 192,500 \\
\text{Actuarial loss on re-measurement (balancing figure)} & \quad 12,500 \\
\text{Closing liability (principle mark already awarded)} & \quad 205,000 \\
\hline
\end{align*}\]

Working 10 – Long-term borrowings

\[\begin{align*}
\text{Opening loan element (300,000 – 23,880 (W5))} & \quad 276,120 \\
\text{Finance cost less interest paid (W6)} & \quad 4,090 \\
\hline
& \quad 280,210 \\
\text{Long-term borrowings of Beta} & \quad 85,000 \\
\hline
& \quad 365,210 \\
\end{align*}\]

Working 11 – Deferred tax

\[\begin{align*}
\text{Alpha + Beta – per draft SOFP (69,000 + 54,000)} & \quad 123,000 \\
\text{On closing fair value adjustments in Beta (W1)} & \quad 9,000 \\
\text{On unrealised profits in inventory (2,000 x 20%)} & \quad (400) \\
\hline
& \quad 131,600 \\
\end{align*}\]

2 Note 1 – Purchase of equity shares in a key supplier

Under the principles of IFRS® 9 – Financial Instruments – equity investments must be measured at fair value because the contractual terms associated with the investment do not entitle the holder to specific payment of interest and principal (sense of the point only needed). 1

The fair value of the investment in entity A at the date of purchase is $480,000 (200,000 x $2.40). ½

The amount actually paid for the shares (incorporating broker’s fee) in entity A on 1 October 20X6 was $489,600 (480,000 x 1.02). ½

The difference between the price paid for the shares and their fair value is $9,600 ($489,600 – $480,000). This difference is regarded as a transaction cost by IFRS 13 – Fair Value Measurement. 1

IFRS 9 would normally require equity investments to be measured at fair value through profit or loss. Where financial assets are measured at fair value through profit or loss, transaction costs are recognised in profit or loss as incurred. Therefore in this case, $9,600 would be taken to profit or loss on 1 October 20X6. 1

Under the principles of IFRS 13, the fair value of an asset is the amount which could be received to sell the asset in an orderly transaction. Where the asset is traded in an active market (as is the case for the investment in entity A), then fair value should be determined with reference to prices quoted in that market. Therefore the fair value of the investment in entity A at the year end is $540,000 (200,000 x $2.70). 1 (principle)

The year-end fair value of $540,000 is unaffected by the broker’s fees which would be incurred if the shares were to be sold – these fees are not a component of fair value measurement. ½ (principle)

The change in fair value of $60,000 ($540,000 – $480,000) between 1 October 20X6 and 30 September 20X7 would be taken to profit or loss at the end of the reporting period. 1

The dividend received of $50,000 (200,000 x 25 cents) would be recognised as other income in profit or loss at 31 March 20X7. 1

Because the shares in entity A are not held for trading, Gamma has the option to make an irrevocable election on 1 October 20X6 to measure the shares at fair value through other comprehensive income. 1 (principle)
Were this election to be made, then the transaction cost would be included in the initial carrying amount of the financial asset, making this $489,600.

The difference between the closing fair value of the investment and its initial carrying amount is $50,400 ($540,000 – $489,600). This is recognised in other comprehensive income.

The dividend income of $50,000 is still recognised in profit or loss regardless of how the financial asset is measured.

Note 2 – Joint manufacture of a product with entity B

Under the principles of IFRS 11 – Joint Arrangements – the agreement with entity B is a joint arrangement. This is because key decisions, e.g. pricing and selling decisions, manufacturing specifications, require the consent of both parties and so joint control is present.

IFRS 11 would regard the type of arrangement with entity B as a joint operation. This is because the two parties have rights to specific assets and liabilities relating to the arrangement and no specific entity has been established.

Because of the type of joint arrangement, each entity will recognise specific assets and liabilities relating to the arrangement (exact wording not necessary – just sense of the point).

This means that Gamma will recognise revenues of $11 million ($22 million x 50%).

Gamma will recognise bad debt expense of $50,000 ($100,000 x 50%).

Gamma’s trade receivables at 30 September 20X7 will be $2.5 million ($5 million x 50%).

Gamma will show a payable to entity B of $750,000 ($1.5 million x 50%) 30 September 20X7.

Gamma’s inventories at 30 September 20X7 will be $1.7 million ($3.8 million – $2.1 million).

Gamma’s cost of sales will be $5.3 million ($7 million – $1.7 million).

3 (a) The timing of the recognition of revenue under IFRS 15 – Revenue from Contracts with Customers – depends on the type of performance obligation the entity has under the contract with the customer. A performance obligation is a distinct promise to transfer goods or services to the customer (sense of the point only required).

IFRS 15 requires that revenue should be recognised when (or as) a particular performance obligation is satisfied.

In many cases (e.g. the sale of goods in the ordinary course of business), performance obligations are satisfied at a point in time. In such cases, the revenue is recognised at the point control of the goods is transferred to the customer.

In some cases (e.g. a contract to construct an asset for use by a customer), performance obligations are satisfied over a period of time. In such cases, the proportion of the total revenue recognised is the proportion of the performance obligation which has been satisfied by the reporting date.

The measurement of revenue is based on the transaction price. The transaction price is the amount of consideration to which an entity expects to be entitled in exchange for transferring the promised goods and services to the customer.

In many cases, where the consideration for the transaction is fixed and payable immediately after the revenue has been recognised (e.g. most sales of goods), the transaction price is the invoiced amount less any sales taxes collected on behalf of third parties.

Where the due date for payment of the invoiced price is ‘significantly different’ (certainly more than 12 months) from the date of recognition of the revenue, then the time value of money should be taken into account when measuring the transaction price. This means that the revenue recognised on the sale of goods with deferred payment terms would be split into a ‘sale of goods’ component and a financing component.

Where the total consideration due from the customer contains variable elements (e.g. the possibility that the customer obtains a discount for bulk purchases depending on the total purchases in a period), then the transaction price should be based on the best estimate of the total amount receivable from the customer as a result of the contract.
(b) Note 1 – Sale of product with right of return

Under the principles of IFRS 15, revenue cannot be recognised on 1 April 20X7 because at that date the consideration is variable and the amount of the variable consideration cannot be reliably estimated.

However, on 1 April 20X7 $80,000 would be removed from inventory and included as a ‘right to recover asset’ (any reasonable description of this would be permitted).

Revenue of $100,000 (the present value of $121,000 receivable in two years) is recognised on 30 June 20X7 when the uncertainty regarding potential returns is resolved.

On the same day, the ‘right to recover asset’ will be de-recognised and transferred to cost of sales.

Delta will also recognise finance income of $2,500 ($100,000 x 10% x 3/12) in the year ended 30 September 20X7.

At 30 September 20X7, Delta will recognise a trade receivable of $102,500 ($100,000 + $2,500).

Note 2 – Sale to a customer with a volume discount incentive

The consideration payable by the customer is variable as it depends on the volume of sales in the two-year period. However, Delta can reliably estimate the outcome and that the volume discount threshold will not be exceeded (sales for 9 months: 20,000 x 24/9 = 53,333). The revenue included for the year ended 30 September 20X6 will be booked at $100 per unit and will be $2 million (20,000 x $100).

During the year ended 30 September 20X7, actual sales volumes and estimates change such that the cumulative revenue should now be booked at $90 per unit. It is now expected that the volume discount threshold will be exceeded. This means that the cumulative revenue relating to these goods at 30 September 20X7 will be $4,950,000 ((20,000 + 35,000) x $90).

The revenue which will actually be booked by Delta for the year ended 30 September 20X7 will be $2,950,000 ($4,950,000 – $2 million recognised in 20X6).

4 Note 1 – Inconsistencies

It is possible for two sets of financial statement to comply with IFRS standards and yet be inconsistent with each other. Some individual IFRS standards allow a choice of accounting treatment and some IFRS standards are only compulsory for listed entities like Epsilon.

Both IFRS 8 – Operating Segments – and IAS® 33 – Earnings per Share – are only compulsory for listed entities. The other company is not currently listed and is not required to give either of these disclosures but can do so on a voluntary basis. If the other company obtains a listing, then they will have to give these disclosures.

IAS 20 – Accounting for Government Grants and Disclosure of Government Assistance – requires government grants to be recognised in profit or loss on a systematic basis over the period in which the entity recognises as expenses the related cost. However, IAS 20 allows entities to choose from two alternative models for presenting the government grants. These are the approach, which Epsilon uses, which deducts the grant in arriving at the non-current asset’s carrying amount and will result in a reduced depreciation charge through profit or loss. The other company uses the allowed alternative of setting up the grant as deferred income and releasing the grant systematically to profit or loss. The net effect on profit or loss will be the same, whichever approach is used. Consistency of choice is required within entities. Therefore the other company could continue to use the deferred income approach to present its government grants even after obtaining a listing.

Note 2 – Pending legal cases

Provisions are covered by IAS 37 – Provisions, Contingent Liabilities and Contingent Assets. IAS 37 states that for a provision to be recognised, an obligating event must have incurred before the year end. In this case, both customer A and B were sold the product before the year end so an obligating event has occurred.
IAS 37 further states that a provision is only recognised when there is a probable outflow of economic benefits. IAS 37 interprets 'probable' to be 50% or more. This is only the case with the supply to customer A, so it is correct to only recognise a provision for customer A's claim.

IAS 37 also states that any provision should be measured based on the best estimate of the likely outflow of economic benefits. In this case, this amount is $10 million.

Any liability arising from the legal case brought by customer B would be regarded as a contingent liability because there is only a possible (rather than a probable) chance of an outflow of economic benefits. In this case, it is dealt with by disclosure, rather than provision.

In addition to the recognition of a provision in the case of customer A's claim, it is also necessary to disclose key facts relating to the case in the notes to the financial statements.

The possible recovery of funds from the insurance company would be regarded as a contingent asset. This would always be the case for possible assets unless it is virtually certain (rather than highly probable) that there will be an inflow of economic benefits. Where there is a probability of an inflow of funds relating to a contingent asset, then this is dealt with by disclosure under IAS 37.

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Note 3 – Statement of profit or loss and other comprehensive income

The principles underpinning the overall presentation of financial statements are set out in IAS 1 – *Presentation of Financial Statements*. IAS 1 requires that all income and expenses are presented in a statement of profit or loss and other comprehensive income.

IAS 1 does not allow entities to choose whether to present income and expenses in the profit or loss or the other comprehensive income section of the statement. IAS 1 states that, unless required or permitted by a specific IFRS standard, all items of income and expense should be presented in the profit or loss section of the statement.

IAS 1 states that the tax relating to items of other comprehensive income is either shown as a separate line in the ‘other comprehensive income’ section of the statement or netted off against each component of other comprehensive income and disclosed in the notes to the financial statements.

The key implication of an item being presented in other comprehensive income rather than profit or loss is that the item would not be taken into account when measuring earnings per share, an important performance indicator for listed entities like Epsilon.