
Answers

Marks

1 Consolidated statement of financial position of Alpha at 31 March 2013

ASSETS	\$'000	
Non-current assets:		
Property, plant and equipment (280,000 + 225,000 + 19,250 (W1) + 6,000 (W1) + 6,120 (W7))	536,370	½ + ½ + ½ + ½
Intangible assets (W1)	6,000	½
Goodwill (W2)	89,000	6½ (W2)
Investment in Gamma (W9)	77,120	2 (W9)
Other investments	40,000	½
	<u>748,490</u>	
Current assets:		
Inventories (85,000 + 56,000 – 3,500 (W4))	137,500	½ + ½
Trade receivables (70,000 + 42,000 – 9,000 (intra-group) – nil (associate))	103,000	½ + ½ + ½
Cash and cash equivalents (14,000 + 11,000)	25,000	½
	<u>265,500</u>	
Total assets	<u><u>1,013,990</u></u>	
EQUITY AND LIABILITIES		
Equity attributable to equity holders of the parent		
Share capital (160,000 + 80,000 (shares issued to acquire Beta))	240,000	1
Retained earnings (W4)	224,201	15 (W4)
Other components of equity (W5)	147,752	4½ (W5)
	<u>611,953</u>	
Non-controlling interest (W3)	84,500	1 (W3)
Total equity	<u>696,453</u>	
Non-current liabilities:		
Contingent consideration	28,000	½
Provisions (W7)	7,387	½
Long-term borrowings (60,000 + 50,000 + 900 (W8))	110,900	½ + ½
Deferred tax (22,000 + 25,000 + 6,250 (W10))	53,250	½ + ½
Total non-current liabilities	<u>199,537</u>	
Current liabilities:		
Trade and other payables (45,000 + 40,000 – 9,000 (intra-group) – nil (associate))	76,000	½
Short-term borrowings (22,000 + 20,000)	42,000	½
Total current liabilities	<u>118,000</u>	40
Total equity and liabilities	<u><u>1,013,990</u></u>	

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

Working 1 – Net assets table – Beta

	1 April 2012 \$'000	31 March 2013 \$'000	For W2	For W4
Share capital	120,000	120,000	½	
Other components of equity	2,400	4,000	½	½
Retained earnings:				
Per accounts of Beta	86,000	115,000	½	½
Property adjustment	20,000	20,000	½	
Extra depreciation ((92,000 – 80,000)/16)		(750)		½
Plant and equipment adjustment	9,000	9,000	½	
Extra depreciation ((120,000 – 111,000)/3)		(3,000)		½
Intangible asset adjustment	8,000	8,000	½	
Extra amortisation (8,000/4)		(2,000)		½
Deferred tax on fair value adjustments	(7,400)	(6,250)	1 (W10)	1 (W10)
Net assets for the consolidation	<u>238,000</u>	<u>264,000</u>		

The post-acquisition increase in net assets is 26,000 (264,000 – 238,000). 1,600 of this increase relates to other components of equity and the balance (24,400) relates to retained earnings.

—	1
<u>4</u>	<u>4½</u>
⇒W2	⇒W4

Working 2 – Goodwill on consolidation (Beta)

	\$'000	
Cost of investment:		
Share exchange (90 million x 8/9 x \$2·80)	224,000	1
Contingent consideration	25,000	½
Fair value of non-controlling interest at date of acquisition (30 million x \$2·60)	<u>78,000</u>	1
	327,000	
Net assets at 1 April 2012 (W1)	(238,000)	4 (W1)
Goodwill	<u>89,000</u>	<u>6½</u>

Working 3 – Non-controlling interest in Beta

	\$'000	
Fair value at date of acquisition (W2)	78,000	½
25% of post-acquisition increase in net assets (26,000 (W1))	<u>6,500</u>	½
	<u>84,500</u>	<u>1</u>

Working 4 – Retained earnings

	\$'000	
Alpha	211,396	½
Adjustment to fair value of contingent consideration (28,000 – 25,000)	(3,000)	½
Adjustment for share based payment (W6)	(1,128)	1½ (W6)
Adjustment for provision (W7)	233	3½ (W7)
Adjustment for carrying value of loan (W8)	(900)	1½ (W8)
Beta (75% x 24,400 (W1))	18,300	½ + 4½ (W1)
Gamma (40% x (76,000 – 66,000))	4,000	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>224,201</u>	<u>15</u>

Working 5 – Other components of equity

	\$'000	
Alpha	5,604	½
Premium on issue of shares to acquire Beta (80 million x \$1·80)	144,000	1
Reversal re: investment in Gamma	(4,500)	1
Adjustment re: share based payment (W6)	1,128	½
Beta (75% x 1,600 (W1))	1,200	1
Gamma (40% (2,000 – 1,200))	320	½
	<u>147,752</u>	<u>4½</u>

Working 6 – Share based payment

	\$'000	
Expected total cost (9·3 million x \$0·36)	3,348	½
Cumulative cost recognised to 31 March 2013 (2/3)	2,232	½
Cumulative cost recognised in previous periods	(1,104)	½
So necessary adjustment equals	<u>1,128</u>	<u>1½</u>
		⇒W4

Working 7 – Provision adjustments

	\$'000	
Provision required at 31 March 2012 (14,250 x 0·48)	6,840	½
Unwinding of discount (6,840 x 8%)	547	1
So provision required at 31 March 2013	<u>7,387</u>	
Amount included in PPE on 31 March 2012	6,840	½
Depreciation to 31 March 2013 (1/9·5)	(720)	½
So added to PPE at 31 March 2013	<u>6,120</u>	
Amount chargeable to profit or loss (547 + 720)	1,267	½
Amount charged in financial statements	(1,500)	½
So necessary adjustment equals	<u>(233)</u>	<u>3½</u>
		⇒W4

Working 8 – Loan adjustment

	\$'000	
Initial carrying amount (20,000 – 1,000)	19,000	½
Finance cost (10%)	1,900	½
	<u>20,900</u>	
Included in draft financial statements	(20,000)	½
So adjustment equals	<u>900</u>	<u>1½</u>
		⇒W4

Working 9 – Investment in Gamma – equity accounting

	\$'000	
Cost	74,000	½
Share of post-acquisition change in net assets:		
Retained earnings (W4)	4,000	½
Other components of equity (W5)	320	½
Unrealised profit (W4)	(1,200)	½
	<u>77,120</u>	<u>2</u>

Working 10 – Deferred tax on fair value adjustments:

Fair value adjustments:

	1 April 2012	31 March 2013	
	\$'000	\$'000	
Property adjustment	20,000	19,250	½
Plant and equipment adjustment	9,000	6,000	½
Intangible asset adjustment	8,000	6,000	½
Net taxable temporary differences	<u>37,000</u>	<u>31,250</u>	
Related deferred tax (20%)	<u>7,400</u>	<u>6,250</u>	½
			<u>2</u>
			⇒W1

- 2 (a) The initial measurement of the loan in € is €49 million (€50 million – €1 million). ½
- The finance cost in € is €4.9 million (€49 million x 10%). ½
- The closing balance of the loan in € is €49.9 million (€49 million + €4.9 million – €4 million). ½
- IAS 21 – *The Effect of Changes in Foreign Exchange Rates* – states that foreign currency transactions are initially recorded at the rate of exchange in force when the transaction was first recognised. ½
- Therefore the loan would initially be recorded at \$68.6 million (€49 million x 1.40). ½
- The finance cost would be recorded at an average rate for the period since it accrues over a period of time. ½
- The finance cost would be \$6.958 million (€4.9 million x 1.42). ½
- The actual payment of interest would be recorded at \$5.8 million (€4 million x 1.45). ½
- The loan balance is a monetary item so it is translated at the rate of exchange at the reporting date. ½
- So the closing loan balance is \$72.355 million (€49.9 million x 1.45). ½
- The exchange differences that are created by this treatment are recognised in profit or loss. ½
- In this case, the exchange difference is ((€68.6 million + €6.958 million – €5.8 million) – \$72.355 million) = \$2.597 million. 1
- This exchange loss is taken to profit or loss. ½
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- (b) As provided in IFRS 11 – *Joint Arrangements* – this is a joint arrangement because two or more parties have joint control of the pipeline under a contractual arrangement. 1
- The arrangement will be regarded as a joint operation because Delta and the other investor have rights to the assets and obligations for the liabilities of this joint arrangement. 1
- This means that Delta and the other investor will each recognise 50% of the cost of constructing the asset in property, plant and equipment. ½
- The borrowing cost incurred on constructing the pipeline should, under the principles of IAS 23 – *Borrowing Costs* –, be included as part of the cost of the asset for the period of construction. ½
- In this case, the relevant borrowing cost to be included is \$500,000 (\$10 million x 10% x 6/12). 1
- The total cost of the asset is \$40.5 million (\$40 million + \$500,000). \$20.25 million is included in the property, plant and equipment of Delta and the same amount in the property, plant and equipment of the other investor. 1
- The depreciation charge for the year ended 31 March 2013 will therefore be \$1,012,500 (\$40.5 million x 1/20 x 6/12). \$506,250 will be charged in the statement of profit or loss of Delta and the same amount in the statement of profit or loss of the other investor. 1
- The other costs relating to the arrangement in the current year totalling \$900,000 (finance cost for the second half year of \$500,000 plus maintenance costs of \$400,000) will be charged to the statements of profit or loss of Delta and the other investor in equal proportions – \$450,000 each. 1
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(c)	Under the principles of IFRS 10 – <i>Consolidated Financial Statements</i> – Delta has control over Epsilon. This is because:	1
	The purpose of setting up Epsilon is to enable Delta to achieve a specific purpose.	1/2
	Epsilon's dependence on Delta indicates that Delta has effective power over Epsilon.	1
	The directors of Delta are acting as <i>de facto</i> agents of Delta in terms of their shareholdings in Epsilon.	1/2
	Delta is exposed to variable returns (on the leased asset) which Delta has the power to affect through its use.	1
	Therefore Delta will consolidate Epsilon and the leased asset and associated liability will be included in the consolidated financial statements as a finance lease.	1
	The rental payments between Delta and Epsilon will be eliminated as an intra-group transaction.	1
		<u>6</u>
		<u>20</u>
3	(a) (i) Revenue is the gross inflow of economic benefits during a period arising in the course of the ordinary activities of a company. Revenue does not include recoverable sales taxes .	1/2 + 1/2 + 1/2
	Revenue is measured at the fair value of the consideration receivable. Fair value takes account of the time value of money and any trade or volume discounts associated with the transaction.	1/2 + 1/2 + 1/2
	(ii) Revenue from the sale of goods can be recognised when:	
	The company has transferred the significant risks and rewards of ownership of the goods to the buyer.	1/2
	The entity has transferred control of the goods to the buyer.	1/2
	The amount of revenue can be measured reliably.	1/2
	It is probable that associated economic benefits will flow to the company.	1/2
	The related costs can be measured reliably.	1/2
	As far as the rendering of services is concerned, an additional condition is that the stage of completion of the service at the end of the reporting period can be measured reliably.	1/2
		<u>6</u>
(b) (i)	\$400,000 is recognised as revenue. IAS 18 states that revenue is reduced to the extent that volume discounts are given.	1
	The prompt payment discount of \$20,000 would not reduce revenue but would be recognised either as part of cost of sales or as a financing expense.	1
		<u>2</u>
(ii)	Because the installation process is simple, revenue from Machine 1 will be recognised on 31 March 2013.	1/2
	Therefore, for Machine 1, \$320,000 will be recognised as revenue and \$160,000 as cost of sales.	1
	Revenue from Machine 2 will not be recognised until 5 April, the date the installation is complete. Until that date, Kappa has not transferred the risks and rewards of ownership.	1/2
	Therefore no revenue or cost of sales will be recognised on Machine 2 in the year ended 31 March 2013.	1
	The cost of producing Machine 2 (\$150,000) will be recognised in inventory at 31 March 2013 and the installation cost (\$10,000) will be recognised as part of cost of sales when the revenue is recognised on 5 April 2013 – within the year ended 31 March 2014.	1
		<u>4</u>
(iii)	No revenue would be recognised on the sale of the property as the risks and rewards of ownership have been retained by Kappa. This is so because the option to re-purchase is almost certain to be exercised, due to the transfer at substantially below market value and the expectation of a rise in property prices.	1

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This transaction will therefore be regarded as a secured loan.	½
The property will remain in the statement of financial position of Kappa.	½
The finance cost for the year ended 31 March 2013 will be \$100,000 (\$2 million x 10% x 6/12). This will be shown in the statement of profit or loss.	1
The closing borrowing will be \$2.1 million (\$2 million + \$100,000). This will be shown as a non-current liability.	1
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(iv) Kappa would recognise revenue on 30 September 2012 because the risks and rewards of ownership have been transferred and Kappa has no continuing managerial involvement with the machine.	½
The amount recognised should be the fair value of the consideration receivable which, under the principles of IFRS 13 – <i>Fair Value Measurement</i> –, involves discounting the consideration to present value.	½
The amount of revenue recognised is \$800,000 (\$1,007,557 x 0.794).	½
Kappa would recognise \$600,000 in cost of sales.	½
Kappa would recognise finance income of \$32,000 (\$800,000 x 8% x 6/12). This will be shown in the statement of profit or loss.	1
Kappa would recognise a closing receivable of \$832,000 (\$800,000 + \$32,000). This will be shown as a non-current asset.	1
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4 (a) Although it is true that the majority of assets and liabilities that are recognised in financial statements are measured based on their original cost, there are a number that are measured at fair value. Three examples of the use of the ‘fair value basis’ are:	
The assets and liabilities of a newly acquired subsidiary are measured in the consolidated financial statements at their fair values at the date of acquisition.	1
Many financial instruments are measured at fair value.	1
Property, plant and equipment can be measured at fair value on a class by class basis.	1
<i>(Tutorial note: Other valid examples – e.g. investment properties or biological assets – would also receive credit.)</i>	
IFRS 13 – <i>Fair Value Measurement</i> – defines fair value as the amount that would be received to sell an asset, or paid to transfer a liability , in an orderly transaction between market participants .	½ + ½ + ½ + ½
The IFRS 13 definition removes the uncertainty that was previously an issue in that it confirms that fair value is an exit measure, not an entry measure.	½
The fair value hierarchy refers to three levels of input into the measurement of fair value. These three levels vary in their reliability, starting with the most reliable and ending with the least reliable:	
Level 1 inputs are market prices where the asset or liability is quoted in an active market. These inputs are given the highest priority when measuring fair values and are not normally subject to any adjustment. An example would be the use of quoted prices to measure the fair value of equity instruments.	1½
Level 2 inputs are inputs into the calculation of fair value that, whilst not market values, are observable to an external user. An example would be the quoted prices of shares in similar entities when measuring the fair value of an unquoted share. Level 2 inputs are sometimes adjusted to reflect differential circumstances.	1½
Level 3 inputs are those that are not observable to an external user. An example would be the assumptions regarding future profits when measuring the fair value of an unquoted share. When measuring fair values, use of Level 3 inputs should be kept to a minimum.	1½
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(b) A reportable segment is an operating segment that satisfies certain materiality criteria.	$\frac{1}{2}$
An operating segment is a component of an entity:	
That engages in business activities from which it may earn revenues and incur expenses .	$\frac{1}{2} + \frac{1}{2}$
Whose operating results are regularly reviewed by the Chief Operating Decision Maker (CODM) .	$\frac{1}{2} + \frac{1}{2}$
For which discrete financial information is available.	$\frac{1}{2}$
The CODM is a function , not a title. The function is to make decisions about allocating resources and assessing performance .	$\frac{1}{2} + \frac{1}{2} + \frac{1}{2}$
The materiality criteria are any one of the following:	$\frac{1}{2}$
Reported revenue is 10% or more of the total revenue of all operating segments.	$\frac{1}{2}$
The absolute amount of its reported profit or loss is 10% or more of the greater of the combined reported profit of all the profit making segments and the combined reported loss of all the segments that reported a loss.	$\frac{1}{2} + \frac{1}{2} + \frac{1}{2}$
Total assets are 10% or more of the total assets of all operating segments.	$\frac{1}{2}$
Two or more operating segments that exhibit similar economic characteristics can be combined into a single operating segment for reporting purposes.	$\frac{1}{2} + \frac{1}{2}$
Even if an operating segment does not meet any of the quantitative thresholds, it can be considered reportable if management believes that information about that segment would be useful to users of the financial statements.	$\frac{1}{2}$
As a minimum, the total external revenue of reportable segments should be at least 75% of total entity revenue. If this is not achieved by applying the size criteria to individual segments, additional reportable segments need to be added until this threshold is achieved.	$\frac{1}{2} + \frac{1}{2}$
	<u>10</u>
	<u>20</u>