
Answers

		<i>Marks</i>
1 (a) Discussion of status of investment in Gamma		
Under the principles of IFRS 10 – <i>Consolidated Financial Statements</i> – Gamma became a subsidiary of Alpha on 1 July 2013 if Alpha obtained control of Gamma on that date.		1
IFRS 10 states that an investor controls an investee if and only if the investor has:		
Power over the investee. Given the absolute size of its shareholding relative to the other shareholdings and the absence of any collective agreements between the other shareholders, it would appear that Alpha does indeed have power over Gamma.		1½
Exposure to variable returns from its involvement with the investee. Alpha’s shareholding will entitle Alpha to dividends which will vary with the level of Gamma’s profits.		1
Ability to use its power to affect those returns. Given its effective control of the board of directors, Alpha is able to control the operating and financial policies of Gamma which will affect its profits and in turn its dividends.		1
Therefore Gamma would be regarded as a subsidiary of Alpha from 1 July 2013.		½
		<u>5</u>
(b) Consolidated statement of profit or loss and other comprehensive income of Alpha for the year ended 31 March 2014		
	\$’000	
Revenue (W1)	928,000	2½
Cost of sales (bal fig)	(527,200)	½
Gross profit (W2)	400,800	7½
Distribution costs (Alpha + Beta + 9/12 x Gamma)	(46,500)	½
Administrative expenses (W4)	(93,500)	2½
Finance costs (W5)	(49,650)	4½
Investment income (33,000 – 80% x 30,000 – 40% x 20,000)	1,000	½ + ½ + ½
Profit before tax	212,150	
Income tax expense (W8)	(62,700)	3
Profit for the year	149,450	
Other comprehensive income:		
Items that will not be reclassified to profit or loss		
Gain on property revaluation (W9)	27,750	2
Actuarial loss on defined benefit retirement benefit plan (W10)	(900)	3
Items that will subsequently be reclassified to profit or loss		½
Cash flow hedges	3,600	1
Total comprehensive income for the year	179,900	
Profit attributable to:		
Owners of the parent (bal fig)	115,960	½
Non-controlling interests (W11)	33,490	3½
	149,450	
Total comprehensive income attributable to:		
Owners of the parent (bal fig)	141,010	½
Non-controlling interests (W12)	38,890	1½
	179,900	
		<u>35</u>
		<u>40</u>

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

Working 1 – Revenue

	\$'000	
Principle consolidate Alpha + Beta + 9/12 x Gamma		1
Alpha + Beta + 9/12 x Gamma	974,000	1/2
Sales of components by Alpha to Beta	(30,000)	1/2
Sale of machine by Alpha to Beta	(16,000)	1/2
	<u>928,000</u>	<u>2 1/2</u>

Working 2 – Gross profit

	\$'000	
Alpha + Beta + 9/12 x Gamma	416,000	1/2
Movement in unrealised profit on sale of components: 1/4 (6,000 – 4,400)	(400)	1 1/2
Unrealised profit on the sale of machine: 3/4 (16,000 – 12,000)	(3,000)	1
Extra depreciation of Gamma's plant: (78,000 – 70,000) x 1/4 x 9/12	(1,500)	1
Extra amortisation of Gamma's development project: (22,000 – 10,000) x 1/10 x 3/12	(300)	1
Impairment of goodwill on acquisition of Beta (W3)	(10,000)	2 1/2 (W3)
	<u>400,800</u>	<u>7 1/2</u>

Working 3 – Impairment of Beta goodwill

	Unit 1 \$'000	Unit 2 \$'000	Unit 3 \$'000	
Carrying value of net assets	215,000	185,000	130,000	1/2
Allocated goodwill	32,000	28,000	20,000	1
	<u>247,000</u>	<u>213,000</u>	<u>150,000</u>	
Recoverable amount	255,000	220,000	140,000	1/2
So impairment equals	<u>Nil</u>	<u>Nil</u>	<u>10,000</u>	1/2
				<u>2 1/2</u>
				⇒W2

Working 4 – Administrative expenses

	\$'000	
Alpha + Beta + 9/12 x Gamma	93,000	1/2
Current service cost – defined benefit retirement benefit plan	4,500	1
Decrease in fair value of contingent liability of Gamma (16,000 – 12,000)	(4,000)	1
(Also acceptable to show as other income or adjustment to cost of sales)	<u>93,500</u>	<u>2 1/2</u>

Working 5 – Finance costs

	\$'000	
Alpha + Beta + 9/12 x Gamma	44,000	1/2
Finance cost on deferred consideration (W6)	4,050	2 (W6)
Finance cost on defined benefit retirement benefit plan (W7)	1,600	2 (W7)
	<u>49,650</u>	<u>4 1/2</u>

Working 6 – Finance cost on deferred consideration

	\$'000	
Present value of future payment (65,340/(1·10) ²)	54,000	1
Annual finance cost (10%)	5,400	1/2
Finance cost for nine month period	4,050	1/2
		<u>2</u>
		⇒W5

Marks

Working 7 – Finance cost on defined benefit retirement benefit plan

	\$'000	
Opening net liability (60,000 – 40,000)	20,000	1
Annual finance cost (8%)	<u>1,600</u>	<u>1</u>
		<u>2</u>
		⇒W5

Working 8 – Income tax expense

	\$'000	
Alpha + Beta + 9/12 x Gamma	64,000	½
Deferred tax consolidation adjustments:		
– PURP on components (25% x 400)	(100)	½
– Unrealised profit on sale of machine (25% x 3,000)	(750)	½
– Fair value adjustments (25% (1,500 + 300))	(450)	1
– Impairment of goodwill (outside scope)	Nil	½
	<u>62,700</u>	<u>3</u>

Working 9 – Gain on property revaluation

	\$'000	
Alpha + whole of Gamma (all post-acquisition)	37,000	1
Deferred tax on gain (25%)	<u>(9,250)</u>	<u>1</u>
	<u>27,750</u>	<u>2</u>

Working 10 – Actuarial loss on defined benefit retirement benefit plan

	\$'000	
Opening net liability (60,000 – 40,000)	20,000	½
Current service cost	4,500	½
Finance cost on net liability (W7)	1,600	½
Contributions	<u>(5,000)</u>	<u>½</u>
	21,100	
Closing net liability (68,000 – 46,000)	<u>(22,000)</u>	<u>½</u>
Actuarial loss (balancing figure)	<u>900</u>	<u>½</u>
		<u>3</u>

Working 11 – Non-controlling interests in profit

	\$'000	\$'000	
Beta			
Profit for the year	60,000		½
Impairment of goodwill	<u>(10,000)</u>		<u>½</u>
	<u>50,000</u>		
NCI (20%)		10,000	½
Gamma			
9/12 x profit for the year	40,500		½
Fair value adjustments (1,500 + 300 (W2))	(1,800)		½
Deferred tax on fair value adjustments (25% x 1,800)	450		½
	<u>39,150</u>		
NCI (60%)		<u>23,490</u>	<u>½</u>
		<u>33,490</u>	<u>3½</u>

Working 12 – Non-controlling interests in total comprehensive income

	\$'000	
NCI in profit (W11)	33,490	½
NCI in Gamma's property revaluation (60% x (12,000 x 75% – the net of tax amount))	<u>5,400</u>	<u>1</u>
	<u>38,890</u>	<u>1½</u>

		Marks
2 (a)	Under the principles of IFRS 2 – <i>Share-based Payment</i> – the granting of share appreciation rights (SARs) to executives is a cash-settled share-based payment.	1
	Cash-settled share-based payments create a liability in the statement of the financial position as they will ultimately be redeemed in cash.	1
	The liability is recognised based on the fair value of the SAR at the reporting date and the expected number of rights which will vest.	$\frac{1}{2} + \frac{1}{2} + \frac{1}{2}$
	Under the principles of IFRS 2 this liability is built up over the vesting period.	1
	Therefore the liability at 31 March 2014 would be \$412,960 (2000 x (200 – 10 – 5 – 7) x \$1.74 x 2/3).	1
	Since the rights are not exercisable until after 31 March 2015, the liability would be shown as a non-current liability.	$\frac{1}{2}$
	The liability at 31 March 2013 would have been \$216,000 (2,000 x (200 – 10 – 10) x \$1.80 x 1/3).	1
	The charge to profit or loss would be \$196,960 – the difference between the closing liability (\$412,960) and the opening liability (\$216,000). This charge would be shown as an operating cost.	<u>1</u>
		8
(b)	This transaction is governed by the principles of IAS 18 – <i>Revenue</i> .	$\frac{1}{2}$
	One of the conditions which IAS 18 imposes before revenue on the sale of goods can be recognised is that the risks and rewards of ownership need to have been passed to the ‘buyer’.	$\frac{1}{2}$
	Given Delta’s continued responsibility for the custody of the goods, and the fact that they are highly likely to be repurchased, this has clearly not happened here.	1
	One of the illustrative examples in the appendix to IAS 18 states that in such circumstances what we effectively have is a financing transaction.	$\frac{1}{2}$
	Therefore, the goods will remain in inventory at cost – being their manufactured cost of \$800,000 plus one year’s storage costs (or their net realisable value, if this is lower than cost).	1
	The net proceeds of \$800,000, being a financial liability, are accounted for under the principles of IFRS 9 – <i>Financial Instruments</i> .	$\frac{1}{2}$
	Under IFRS 9, most financial liabilities are measured at amortised cost using the effective interest method and this would certainly apply here.	1
	The finance cost for the period would be \$64,000 (\$800,000 x 8%). This would be shown in the statement of profit or loss.	1
	The closing financial liability would be \$864,000 (\$800,000 + \$64,000). This would be shown as a current liability since the ‘repurchase’ occurs on 31 March 2015 – 12 months after the reporting date.	<u>1</u>
		7
(c)	Under the principles of IAS 17 – <i>Leases</i> – the lease of the machine is an operating lease because the risks and rewards of ownership of the machine remain with Epsilon. The lease is for only three years of the eight-year life and Epsilon is responsible for breakdowns, etc.	1
	Therefore Delta will recognise lease rentals as an expense in the statement of profit or loss. IAS 17 states that this should normally be done on a straight-line basis.	1
	The total lease rentals payable over the whole lease term are \$1,050,000 (\$210,000 x 5). Therefore the charge for the current year is \$350,000 (\$1,050,000 x 1/3).	1
	The difference between the charge for the period (\$350,000) and the rent actually paid (\$210,000) will be shown as a liability in the statement of financial position at 31 March 2014. This amount will be \$140,000.	1
	\$70,000 (2 x \$210,000 – \$350,000) of this liability will be current and \$70,000 non-current.	<u>1</u>
		5
		20

		Marks
3 (a) (i)	The tax base of an asset is the tax deduction which will be available in future when the asset generates taxable economic benefits . If the future economic benefits will not be taxable , the tax base of an asset is its carrying value.	1 + ½
	The tax base of a liability is its carrying value, less the tax deduction which will be available when the liability is settled . For revenue received in advance (or deferred income), the tax base is its carrying value, less any amount of the revenue which will not be taxed in future periods .	1 + ½ <u>3</u>
(ii)	A taxable temporary difference arises when the carrying value of an asset exceeds its tax base or the carrying value of a liability is less than its tax base.	1
	A deductible temporary difference arises in the reverse circumstances (when the carrying value of an asset is less than its tax base or the carrying value of a liability is greater than its tax base).	1 <u>2</u>
(iii)	IAS 12 – <i>Income Taxes</i> – requires that (with specific exceptions) deferred tax liabilities are recognised on all taxable temporary differences.	1
	IAS 12 allows deferred tax assets to be recognised on deductible temporary differences when future taxable profits are expected to be available against which to offset the future tax deductions the deductible temporary differences are expected to generate.	1 <u>2</u>
(b) (i)	The tax loss creates a potential deferred tax asset for the Kappa group since its carrying value is nil and its tax base is \$3 million.	1
	However, no deferred tax asset can be recognised because there is no prospect of being able to reduce tax liabilities in the foreseeable future as no taxable profits are anticipated.	1 <u>2</u>
(ii)	The provision creates a potential deferred tax asset for the Kappa group since its carrying value is \$2 million and its tax base is nil.	1
	This deferred tax asset can be recognised because Kappa is expected to generate taxable profits in excess of \$2 million in the year to 31 March 2015.	1
	The amount of the deferred tax asset will be \$500,000 (\$2 million x 25%).	½
	This asset will be presented as a deduction from the deferred tax liabilities caused by the (larger) taxable temporary differences.	½ <u>3</u>
(iii)	The development costs have a carrying value of \$1.52 million (\$1.6 million – (\$1.6 million x 1/5 x 3/12)).	1
	The tax base of the development costs is nil since the relevant tax deduction has already been claimed.	1
	The deferred tax liability will be \$380,000 (\$1.52 million x 25%). All deferred tax liabilities are shown as non-current .	½ + ½ <u>3</u>
(iv)	No deferred tax liability arises in respect of goodwill on consolidation when it is created. This is a specific exception referred to in IAS 12.	1
	As a consequence of this, no adjustment is made for deferred tax purposes when goodwill is impaired. Therefore there are no deferred tax implications for the consolidated statement of financial position.	1 <u>2</u>
(v)	The carrying value of the loan at 31 March 2014 is \$10.78 million (\$10 million – \$200,000 + (\$9.8 million x 10%).	1
	The tax base of the loan is \$10 million (\$10.78 million – (\$980,000 – \$200,000)).	½
	This creates a deductible temporary difference of \$780,000 and a potential deferred tax asset of \$195,000 (\$780,000 x 25%).	½

	Marks
Due to the availability of taxable profits next year (see part (ii) above), this asset can be recognised as a deduction from deferred tax liabilities.	1
	<u>3</u>
	<u>20</u>
4 (a) From 1 January 2014, Sigma would be regarded as a related party of Omega under IAS 24 – <i>Related Party Disclosures</i> .	1
This is because Sigma is controlled by the close family member of one of Omega’s key management personnel .	$\frac{1}{2} + \frac{1}{2} + \frac{1}{2}$
This means that, from 1 January 2014 , the purchases from Sigma would be regarded as related party transactions .	1
Transactions with related parties need to be disclosed in the notes to the financial statements, together with the nature of the relationship . It is irrelevant whether or not these transactions are at normal market rates.	$\frac{1}{2} + \frac{1}{2} + \frac{1}{2}$
The disclosures would state that a company controlled by the spouse of a director supplied goods to the value of \$4.5 million (3 x \$1.5 million) in the current accounting period. It would not be necessary to name the company.	$1 + 1$
	<u>7</u>
(b) Under IAS 38 – Intangible Assets – intangible assets can only be recognised if they are identifiable and have a cost which can be reliably measured.	$\frac{1}{2} + \frac{1}{2} + \frac{1}{2}$
These criteria are very difficult to satisfy for internally developed intangibles.	$\frac{1}{2}$
For these reasons, IAS 38 specifically prohibits recognising advertising expenditure as an intangible asset.	1
The issue of how successful the store is likely to be does not affect this prohibition.	$\frac{1}{2}$
Therefore your colleague is correct in principle that such costs should be recognised as expenses.	$\frac{1}{2}$
However, the costs would be recognised on an accruals basis.	$\frac{1}{2}$
Therefore, of the advertisements paid for before 31 March 2014, \$700,000 would be recognised as an expense and \$100,000 as a pre-payment in the year ended 31 March 2014.	1
The \$400,000 cost of advertisements paid for since 31 March 2014 would be charged as expenses in the year ended 31 March 2015.	$\frac{1}{2}$
	<u>6</u>
(c) Under the principles of IAS 21 – Foreign Currency Transactions – the asset and liability would initially be recognised at the rate of exchange in force at the transaction date – 1 January 2014. Therefore the amount initially recognised would be \$200,000 (2 million kroner x 1/10).	$\frac{1}{2} + \frac{1}{2} + \frac{1}{2}$
The liability is a monetary item so it is retranslated using the rate of exchange in force at 31 March 2014 . This makes the closing liability \$250,000 (2 million kroner x 1/8).	$\frac{1}{2} + \frac{1}{2} + \frac{1}{2}$
The loss on re-translation of \$50,000 (\$250,000 – \$200,000) is recognised in the statement of profit or loss .	$\frac{1}{2} + \frac{1}{2}$
The machine is a non-monetary asset carried at historical cost . Therefore it continues to be translated using the rate of 10 kroner to \$1.	$\frac{1}{2} + \frac{1}{2} + \frac{1}{2}$
Depreciation of \$12,500 (\$200,000 x $\frac{1}{4}$ x 3/12) would be charged to profit or loss for the year ended 31 March 2014.	$\frac{1}{2} + \frac{1}{2}$
The closing balance in property, plant and equipment would be \$187,500 (\$200,000 – \$12,500). This would be shown as a non-current asset in the statement of financial position.	$\frac{1}{2}$
	<u>7</u>
	<u>20</u>