

ACCA

Strategic Professional

Strategic Business Reporting (INT & UK) (SBR)

EXAM KIT

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Acknowledgements

These materials are reviewed by the ACCA examining team. The objective of the review is to ensure that the material properly covers the syllabus and study guide outcomes, used by the examining team in setting the exams, in the appropriate breadth and depth. The review does not ensure that every eventuality, combination or application of examinable topics is addressed by the ACCA Approved Content. Nor does the review comprise a detailed technical check of the content as the Approved Content Provider has its own quality assurance processes in place in this respect.

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Versions of some questions in this Exam Kit may also be available on the ACCA Practice Platform on the ACCA website. They are a very useful reference, in particular to attempt using ACCA's exam software. However, you should be aware that ACCA will decide when those questions will be amended for syllabus changes or replaced, so they may differ slightly from the versions in this Exam Kit

This document references IFRS® Standards and IAS Standards®, which are authored by the International Accounting Standards Board (the Board), and published in the 2022 IFRS Standards Red Book.

Key features in this edition

In addition to providing a wide ranging bank of real past exam questions, we have also included in this edition:

- Paper specific information and advice on exam technique.
- Our recommended approach to make your revision for this particular subject as effective as possible.

This includes step by step guidance on how best to use our Kaplan material (Study Text, Pocket Notes and Exam Kit) at this stage in your studies.
- Enhanced tutorial answers packed with specific key answer tips, technical tutorial notes and exam technique tips from our experienced tutors.
- Complementary online resources including full tutor debriefs and question assistance to point you in the right direction when you get stuck.

You will find a wealth of other resources to help you with your studies on the following sites:

www.MyKaplan.co.uk

www.accaglobal.com/students/

UK GAAP focus

The majority of the UK syllabus exam will be the same as the international exam, which is based on International Financial Reporting Standards (IFRS® Standards and IAS® Standards). The UK exam will also test some differences between UK GAAP and International Financial Reporting Standards. There could also be a focus on the requirements of Companies Act. It is anticipated that the differences will account for no more than 20% of the SBR UK paper.

UK syllabus students should refer to the list of examinable documents for the UK examination. This document is available on the ACCA web site at www.accaglobal.com

To assist UK syllabus students, additional questions and answers based on examinable UK content are included in this Exam Kit.

Quality and accuracy are of the utmost importance to us so if you spot an error in any of our products, please send an email to mykaplanreporting@kaplan.com with full details.

Our Quality Co-ordinator will work with our technical team to verify the error and take action to ensure it is corrected in future editions.

INDEX TO QUESTIONS AND ANSWERS

KEY TO THE INDEX

PAPER ENHANCEMENTS

We have added the following enhancements to the answers in this Exam Kit:



Key answer tips

All answers include key answer tips to help your understanding of each question.



Tutorial note

All answers include more tutorial notes to explain some of the technical points in more detail.



Top tutor tips

For selected questions, we 'walk through the answer' giving guidance on how to approach the questions with helpful 'tips from a top tutor', together with technical tutor notes.

These answers are indicated with the 'footsteps' icon in the index.

ONLINE ENHANCEMENTS



Answer debrief

For selected questions, we recommend that they are to be completed in full exam conditions (i.e. properly timed in a closed book environment).

In addition to the examining team's technical answer, enhanced with key answer tips and tutorial notes in this exam kit, online you can find an answer debrief by a top tutor that:

- works through the question in full
- explains key elements of the answer
- ensures that the easy marks are obtained as quickly as possible.

These questions are indicated with the 'video' icon in the index.

Answer debriefs will be available on MyKaplan at:

www.mykaplan.co.uk


























SECTION A QUESTIONS

			Page number		Past exam (Adapted)
Group financial statements			Question	Answer	
1	Chuckle		1	117	Sep/Dec 21
2	Columbia		3	125	Mar/Jun 21
3	Sugar		5	134	Sep/Dec 20
4	Humming		7	142	Mar 20 (A)
5	Luploid		9	149	Sep/Dec 19 (A)
6	Carbise		11	155	Mar/Jun 19
7	Moyes		12	163	Dec 18 (A)
8	Banana		14	169	Sep 18 (A)
9	Bubble		17	176	
10	Jocatt		19	181	
11	Zippy		21	185	
12	Ashanti		23	191	
13	Trailer		25	197	
14	Weston		27	204	
15	Joey		30	212	
16	Parsley		32	217	
17	Marchant		35	223	
18	Angel		37	230	
19	Traveler		42	236	
20	Rose		44	243	

Reporting and ethical implications

21	Agency Group		46	250	Sep/Dec 21
22	Bismuth		47	255	Mar/Jun 21
23	Calibra		49	260	Sep/Dec 20
24	Bagshot		50	264	Mar 20
25	Stent		51	270	Sep/Dec 19
26	Hudson		52	275	Mar/Jun 19 (A)
27	Fiskerton		54	281	Dec 18
28	Farham		55	285	Sep 18
29	Cloud		56	289	
30	Garden		57	292	
31	Cherry		58	296	
32	Anouk		60	300	

SECTION B QUESTIONS

			Page number		Past exam (Adapted)
			Question	Answer	
33	Stem		61	303	Sep/Dec 21
34	Symbal		62	310	Sep/Dec 21
35	Sitka		64	317	Mar/Jun 21
36	Colat		65	321	Mar/Jun 21
37	Corbel		67	328	Sep/Dec 20
38	Handfood		68	334	Sep/Dec 20
39	Leria		70	338	Mar 20
40	Ecoma		71	343	Mar 20 (A)
41	Digiwire		73	348	Sep/Dec 19 (A)
42	Guidance		74	356	Sep/Dec 19 (A)
43	Crypto		76	361	Mar/Jun 19
44	Zedtech		77	366	Mar/Jun 19 (A)
45	Fill		78	371	Dec 18 (A)
46	Holls	 	79	374	Dec 18
47	Skizer		81	381	Sep 18 (A)
48	Toobasco		82	387	Sep 18 (A)
49	Player Two		84	392	
50	Mehran		86	394	
51	Carsoon		87	398	
52	Skye		89	400	
53	Whitebirk		90	403	
54	Business combinations		91	406	
55	Margie		92	411	
56	Kayte		94	415	
57	Verge		95	418	
58	Aron		96	422	
59	Klancet		97	425	
60	Emcee		99	429	
61	Gasnature	 	100	433	
62	Evolve	 	101	437	
63	Artwright		102	440	
64	Lucky Dairy		104	443	

UK GAAP focus		Page number		Past exam (Adapted)
		Question	Answer	
65	Stem	107	447	Sep/Dec 21
66	Sitka	107	450	Mar/Jun 21
67	Corbel	109	452	Sep/Dec 20
68	Leria	110	454	Mar 20
69	Digiwire	111	456	Sep/Dec 19
70	Crypto	111	458	Mar/Jun 19
71	Fill	112	460	Dec 18 (A)
72	Skizer	113	462	Sep 18 (A)
73	Bobarra	114	464	
74	Harris	114	467	
75	Rowling	115	468	
76	Toto	115	470	
77	Howey	115	471	
78	Loki	116	473	

ANALYSIS OF PAST EXAMS

The table below summarises the key topics that have been tested in recent examinations.

Note that the references are to the number of the question in this edition of the exam kit.

	Sep 2018	Dec 2018	Mar/Jun 2019	Sep/Dec 2019	Mar 2020	Sep/Dec 2020	Mar/Jun 2021	Sep/Dec 2021
Groups question								
Goodwill calculations	Q8		Q6	Q5	Q4	Q3	Q2	Q1
Goodwill impairments				Q5				
Step acquisitions						Q3		Q1
Disposals		Q7	Q6					
Control-to-control								
Overseas subsidiaries			Q6		Q4			
Definition of a business	Q8							
Definition of control							Q2	Q1
Acquisition accounting							Q2	
Associates	Q8							Q1
Joint arrangements								Q33
Statement of cash flows		Q7				Q3		
Ethical issues	Q28	Q27	Q26	Q25	Q24	Q23	Q22	Q21
Conceptual Framework	Q47	Q7 Q45 Q46		Q41				
Accounting standards								
IAS 1								
IAS 2		Q45						
IAS 7	Q48	Q7						
IAS 8								
IAS 10								
IAS 12		Q46	Q26	Q25				Q1
IAS 16							Q36	
IAS 19			Q26	Q41	Q40	Q3 Q38	Q2	
IAS 20								
IAS 21			Q6		Q4			Q21
IAS 23						Q23		
IAS 24				Q25	Q24			
IAS 27							Q35	
IAS 28	Q8		Q43	Q41 Q42				Q33
IAS 32				Q25			Q22	Q34
IAS 33								
IAS 34								
IAS 36	Q28	Q45		Q5	Q39	Q37	Q22 Q36	
IAS 37	Q28	Q45	Q22		Q24 Q40	Q37	Q36	Q34
IAS 38	Q47				Q39	Q37	Q35	Q21 Q34
IAS 40								
IAS 41								
IFRS 1								
IFRS 2				Q5				
IFRS 3	Q8	Q45	Q6	Q5				

	Sep 2018	Dec 2018	Mar/Jun 2019	Sep/Dec 2019	Mar 2020	Sep/Dec 2020	Mar/Jun 2021	Sep/Dec 2021
IFRS 5	Q28	Q7	Q6		Q4	Q37		
IFRS 7								
IFRS 8								
IFRS 9	Q8		Q43	Q41	Q4		Q36	
IFRS 10			Q43	Q42				
IFRS 11		Q45	Q43	Q41				
IFRS 12								
IFRS 13				Q5 Q41	Q4		Q2 Q35	
IFRS 15	Q47	Q27	Q44	Q41		Q23	Q35	Q21
IFRS 16		Q27	Q43		Q39 Q40		Q35	Q33
SMEs Standard						Q38		
Analysis								
APMs	Q48							
Ratios			Q43	Q42				Q33
Disclosures		Q46						Q34
Integrated reporting	Q47					Q38		
Sustainability			Q44 (A)		Q40		Q36	
Current issues	*	Q46	*	*	*		Q36	Q34

* The current issue examined is no longer an examinable topic and so does not feature in this Exam Kit, or the particular current issue examined now falls within another area of the syllabus.

EXAM TECHNIQUE

- **Divide the time** you spend on questions in proportion to the marks on offer:
Whatever happens, always keep your eye on the clock and **do not over run on any part of any question!**
- If you **get completely stuck** with a question:
 - move on
 - **return to it later.**
- Stick to the question and **tailor your answer** to what you are asked.
 - pay particular attention to the verbs in the question.
- If you do not understand what a question is asking, **state your assumptions.**
Even if you do not answer in precisely the way the examiner hoped, you should be given some credit, if your assumptions are reasonable.
- You should do everything you can to make things easy for the marker.
The marker will find it easier to identify the points you have made if you leave plenty of space between the points that you are making.
- **Discursive questions:**
Your answer should have a clear structure. Use headings and paragraphs to provide focus.
Be concise and stay on topic. You will score no marks if you do not answer the question.
- **Workings:**
It is essential to include all your workings in your answers – method marks are available even if your final answer is incorrect.
If your exam is computer based, make sure you reference any calculations performed in the spreadsheet.

PAPER SPECIFIC INFORMATION

THE EXAM

FORMAT OF THE EXAM

	<i>Number of marks</i>
Section A: Two compulsory questions	50
Section B: Two compulsory questions of 25 marks each	50
	<hr/>
	100
	<hr/>
Total time allowed:	3 hours 15 minutes.

Note that:

- The first question in Section A will be worth 30 marks. It will always test group accounting. In addition to the consideration of the numerical aspects of group accounting (max 25 marks), a discussion and explanation of these numbers will be required. This question will also test other areas of the syllabus.
- The second question in Section A will be worth 20 marks. It requires consideration of (i) the reporting implications and (ii) the ethical implications of specific events in a given scenario. Two professional marks will be awarded in this question for the application of ethical principles to the scenario.
- Section B consists of two questions, which may be scenario or case-study or essay based and will contain both discursive and computational elements. Section B could deal with any aspect of the syllabus but will always include either a full question, or part of a question, that tests the analysis section of the syllabus. Two professional marks will be awarded in the Section B question that requires analysis.

PASS MARK

The pass mark for all ACCA Qualification examinations is 50%.

The UK exam

The Examiner has indicated that Section B questions in the UK exam will be adapted to assess UK specific content. These questions may be based on either a single entity or a group and will be worth approximately 15-20 marks. They may have discursive and/or numerical content and requirements, and could cover the following syllabus areas:

- The financial reporting requirements for UK and Republic of Ireland entities (UK GAAP) and their interaction with the Companies Act requirements
- The reasons why an entity might choose to adopt FRS 101 or FRS 102
- The scope and basis of preparation of financial statements under UK GAAP
- The concepts and pervasive principles set out in FRS 102
- The principal differences between UK GAAP and International Financial Reporting Standards.

Note that the UK syllabus exam will be denominated in dollars (identified as \$); this Exam Kit adopts the same notation and style for UK syllabus content.

DETAILED SYLLABUS

The detailed syllabus and study guide written by the ACCA can be found at:

www.accaglobal.com/student

KAPLAN'S RECOMMENDED REVISION APPROACH

QUESTION PRACTICE IS THE KEY TO SUCCESS

Success in professional examinations relies upon you acquiring a firm grasp of the required knowledge at the tuition phase. In order to be able to do the questions, knowledge is essential.

However, the difference between success and failure often hinges on your exam technique on the day and making the most of the revision phase of your studies.

The **Kaplan Study Text** is the starting point, designed to provide the underpinning knowledge to tackle all questions. However, in the revision phase, pouring over text books is not the answer.

Kaplan Online progress tests help you consolidate your knowledge and understanding and are a useful tool to check whether you can remember key topic areas.

Kaplan Pocket Notes are designed to help you quickly revise a topic area, however you then need to practice questions. There is a need to progress to full exam standard questions as soon as possible, and to tie your exam technique and technical knowledge together.

The importance of question practice cannot be over-emphasised.

The recommended approach below is designed by expert tutors in the field, in conjunction with their knowledge of the examining team and their recent real exams.

The approach taken for the Applied Skills exams is to revise by topic area. However, with the Strategic Professional exams, a multi topic approach is required to answer the scenario based questions.

You need to practice as many questions as possible in the time you have left.

OUR AIM

Our aim is to get you to the stage where you can attempt exam standard questions confidently, to time, in a closed book environment, with no supplementary help (i.e. to simulate the real examination experience).

Practising your exam technique on examination-style questions, in timed conditions, is also vitally important for you to assess your progress and identify areas of weakness that may need more attention in the final run up to the examination.

In order to achieve this we recognise that initially you may feel the need to practice some questions with open book help and exceed the required time.

The approach below shows you which questions you should use to build up to coping with exam standard question practice, and references to the sources of information available should you need to revisit a topic area in more detail.

EXAMINER'S COMMENTS

We have included many of the examiner's comments to the examination questions in this kit for you to see the main pitfalls that students fall into with regard to technical content.

However, too many times in the general section of the report, the examiner comments that students had failed due to:

- 'misallocation of time'
- 'running out of time' and
- showing signs of 'spending too much time on an earlier question and clearly rushing the answer to a subsequent question'.

Good exam technique and time management is vital.

The examiners have also stressed the importance of carrying forward knowledge from FR. This is highlighted as a common weakness in candidate's scripts and is often the difference between a pass and a fail. Do not neglect the financial reporting topics and skills garnered within FR as they are imperative to SBR success.

Another regularly raised point by the examiner's team is the need to apply knowledge to the scenarios. It is not enough to merely state the required rules and knowledge learnt from the study material. Application to the scenario carries a substantially greater number of marks than just knowledge of the relevant rules.

STRATEGIC PROFESSIONAL COMPUTER BASED EXAMINATIONS

We advise consulting the ACCA Global website for additional CBE revision resources. On the ACCA website there is a CBE demonstration. It is **ESSENTIAL** that you attempt this before your real CBE. You will become familiar with how to move around the SBE screens and the way that questions are formatted, increasing your confidence and speed in the actual exam.

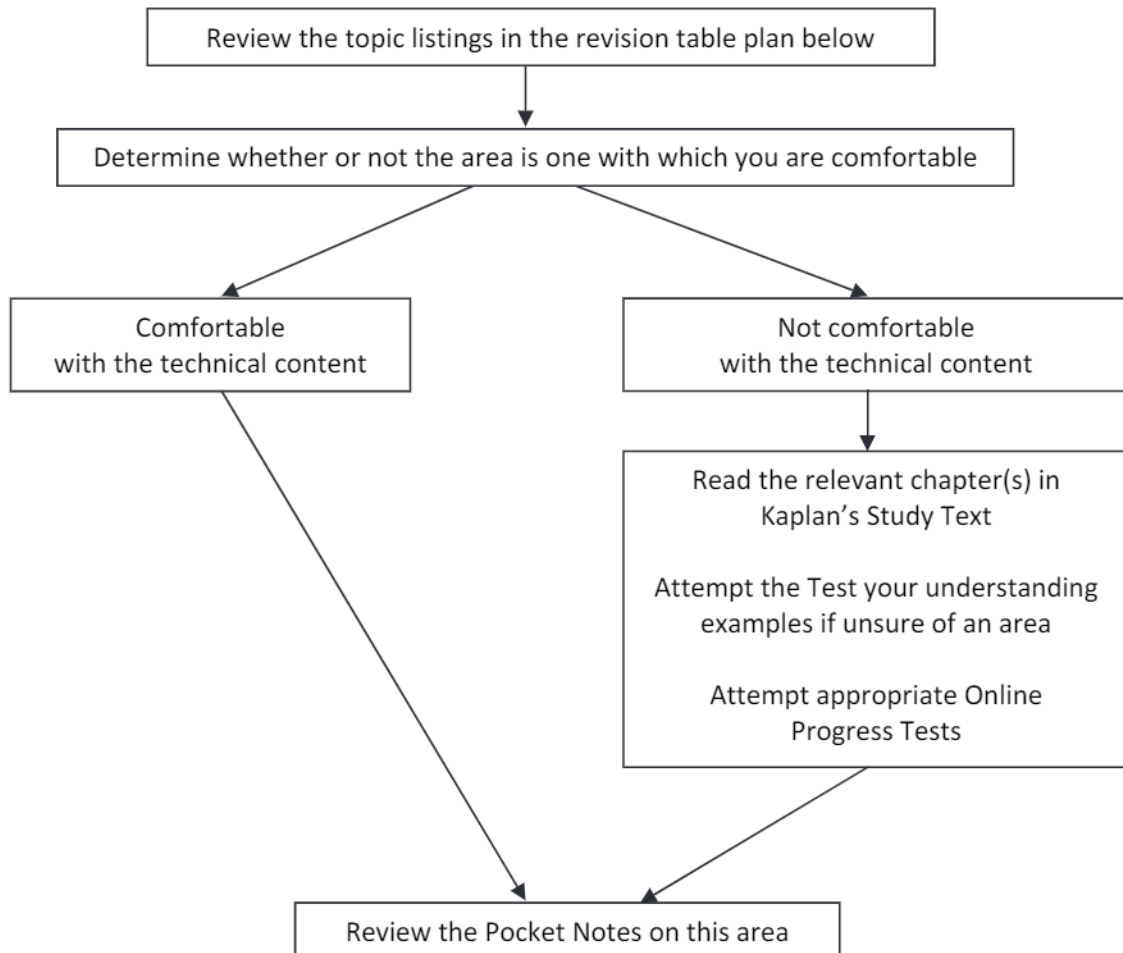
Be sure you understand how to use the **software** before you start the exam. If in doubt, ask the assessment centre staff to explain it to you.

Questions are **displayed on the screen** and answers are entered using keyboard and mouse.

For additional support with your studies please also refer to the ACCA Global website.

THE KAPLAN SBR REVISION PLAN

Stage 1: Assess areas of strengths and weaknesses



Stage 2: Practice questions

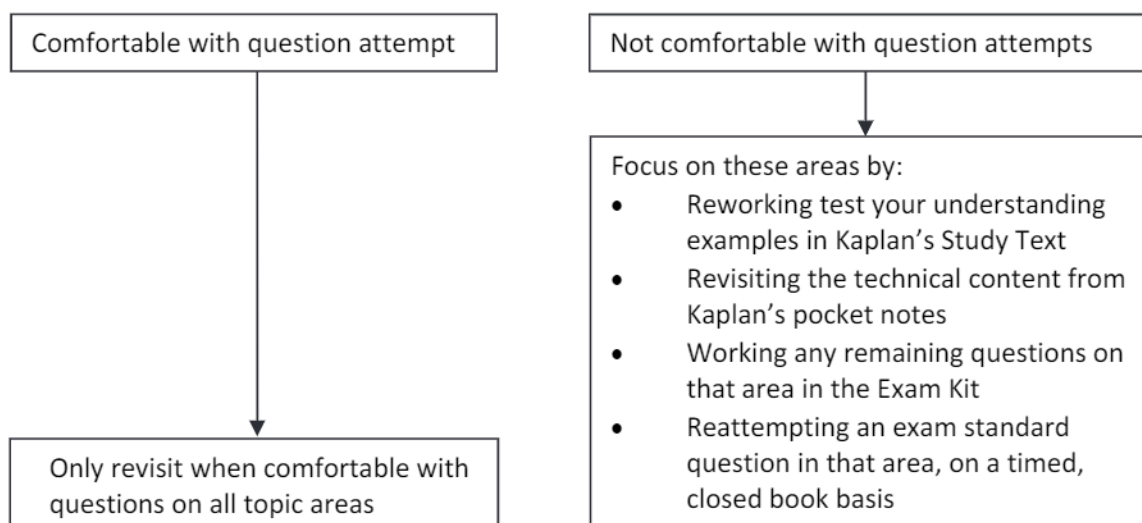
Follow the order of revision of topics as recommended in the revision table plan below and attempt the questions in the order suggested.

Try to avoid referring to text books and notes and the model answer until you have completed your attempt.

Try to answer the question in the allotted time.

Review your attempt with the model answer and assess how much of the answer you achieved in the allocated exam time.

Fill in the self-assessment box below and decide on your best course of action.



Note that:



The 'footsteps questions' give guidance on exam techniques and how you should have approached the question.

Stage 3: Final pre-exam revision

We recommend that you **attempt at least one full mock examination** containing a set of previously unseen exam standard questions.

It is important that you get a feel for the breadth of coverage of a real exam without advanced knowledge of the topic areas covered – just as you will expect to see on the real exam day.

Ideally this mock should be sat in timed, closed book, real exam conditions and could be:

- a mock examination offered by your tuition provider, and/or
- one of the specimen exams.

KAPLAN'S DETAILED REVISION PLAN

<i>Topic</i>	<i>Study Text Chapter</i>	<i>Pocket Note Chapter</i>	<i>Questions to attempt</i>	<i>Tutor guidance</i>	<i>Date attempted</i>	<i>Self-assessment</i>
The financial reporting framework	1	1	Q45 Q46(a) Q47(a)	Ensure that you know the contents of the <i>Conceptual Framework</i> and that you are able to apply it to transactions.		
Ethical and professional principles	2	2	Q21 Q22 Q23 Q24	Ensure that you can apply the <i>ACCA Code of Ethics and Conduct</i> to practical scenarios.		
Reporting financial performance						
Fair value measurement	1	1	Q50(a)	You must know the definition of fair value and be able to apply it. Make sure that you know the markets used to measure fair value and the levels of inputs to fair value measurement.		
Performance reporting and revenue	3, 4	3, 4	11(b) Q23(a) Q27(b) Q41(a)	This could include revenue recognition or the presentation of discontinued activities.		
Non-current assets, agriculture and inventories.	5, 6	5, 6	Q37 Q39 Q61(b)	There are several reporting standards within this heading. In particular, issues around property, plant and equipment, intangible assets, and impairment are regularly examined. Don't forget smaller areas, like government grants.		

Topic	Study Text Chapter	Pocket Note Chapter	Questions to attempt	Tutor guidance	Date attempted	Self-assessment
Foreign currency transactions	7	7	Q9(b) Q63(c)	Ensure that you know how to account for exchange differences arising on overseas transactions within an individual company's financial statements.		
Leases	8	8	Q33 Q39(a) Q43(b)	Ensure that you know how to determine when a contract contains a lease. You must be able to account for leases from the perspective of the lessee and the lessor, as well as sale and leaseback transactions.		
Employee benefits	9	9	Q2(b) Q26(a) Q34(d) Q40(b) Q41(c)	Ensure that you understand how to account for defined benefit and defined contribution schemes.		
Share-based payment	10	10	Q5(c) Q55(a)	Ensure that you understand how to account for both cash-settled transactions and equity-settled transactions.		
Provisions and events after the reporting period	11	11	Q36(c) Q40(b) Q50(b)	Ensure that you know when a legal or constructive obligation arises, and that you can apply the definition of an adjusting and non-adjusting event per IAS 10.		
Financial instruments	12	12	Q43(a) Q58 Q63	Ensure that you understand and can apply recognition, measurement and classification rules relating to financial instruments per IAS 32 and IFRS 9.		

<i>Topic</i>	<i>Study Text Chapter</i>	<i>Pocket Note Chapter</i>	<i>Questions to attempt</i>	<i>Tutor guidance</i>	<i>Date attempted</i>	<i>Self-assessment</i>
Income taxes	13	13	Q1 (b) Q25(a) Q46(b)	The main focus is likely to be the recognition and measurement of deferred tax assets and liabilities.		
Segment reporting	14	14	Q59(a)	Ensure that you can define a reportable segment and apply the definition to information provided. It is also important to know whether two segments can be aggregated.		
Related parties	15	15	Q24(a)	Ensure you can identify related parties per IAS 24, and the implications for any transactions which they may enter into.		
Small entities	17	17	Q38(a) Q53(a)	Ensure that you know the key differences between full IFRS Standards and the IFRS for SMEs Standard.		
Changes in accounting regulation	16, 23	16, 23	Q44(b) Q53(b) Q62(b)	You must be able to discuss the implications of adopting new accounting regulation. You should also ensure you are up-to-date with current issues in the profession.		

Topic	Study Text Chapter	Pocket Note Chapter	Questions to attempt	Tutor guidance	Date attempted	Self-assessment
Group financial statements						
Basic groups, including associates and joint arrangements	18	18	Q1 Q5 Q8	Ensure that you understand the standard workings required for subsidiaries in group financial statements, as well as key definitions – such as ‘control’, ‘joint control’ and ‘significant influence’.		
Changes in group structure	19	19	Q1 Q11 Q12	Ensure that you know how to account for share transactions where control is either gained, lost or retained.		
Foreign currency subsidiaries	20	20	Q4 Q6	Ensure that you can consolidate a foreign subsidiary and can calculate the exchange differences that arise on its net assets, profit and goodwill.		
Statements of cash flows	21	21	Q3 Q7	Ensure that you know the format of a statement of cash flows and can deal with changes in group structure within the statement.		
Interpretation for stakeholders	22	22	Q38(a) Q40(a) Q42(b) Q46(b) Q48	Ensure that you are happy with the interpretation of financial and non-financial information, including additional performance measures. You must also be able to discuss the framework for integrated reporting and sustainability.		

Note that not all of the questions are referred to in the programme above. The remaining questions in the Exam Kit are for extra practice for those who require more questions on some areas.

Section 1

PRACTICE QUESTIONS

SECTION A QUESTIONS – GROUP FINANCIAL STATEMENTS

1 CHUCKLE (SEP/DEC 2021) *Walk in the footsteps of a top tutor*

Background

Chuckle Co has an equity interest in a number of entities including Grin Co. Chuckle Co has recently acquired additional equity in Grin Co and the directors of Chuckle Co are unsure as to how this may impact upon their consolidated financial statements. The year end is 31 March each year.

Initial acquisition of Grin Co

On 1 April 20X2, Chuckle Co acquired 30% of the equity shares of Grin Co. The consideration consisted of \$100 million cash. The carrying amount of the net assets of Grin Co on 1 April 20X2 were \$286 million which was the same as their fair value. Since then, Grin Co has been correctly treated as an associate in the consolidated financial statements of Chuckle Co.

The remaining 70% of the equity of Grin Co at 1 April 20X2 is owned by a few other investors, none of which own more than 10% of the equity of Grin Co. Analysis shows that all shareholders have voted independently in the past. Chuckle Co and Grin Co share some key management personnel.

Subsequent acquisition of Grin Co

Chuckle Co acquired a further 18% of Grin Co's equity on 1 April 20X6. The consideration for the further 18% of the equity shares of Grin Co on 1 April 20X6 was \$66 million in cash. The fair value of the original 30% equity interest was \$127 million at 1 April 20X6. The carrying amount of the net assets of Grin Co on 1 April 20X6 was \$348 million which included some land which had been revalued upwards by \$15 million and correctly accounted for on 1 April 20X5.

Deferred tax at 20% had also been correctly accounted for on this gain in the individual statement of financial position of Grin Co as at 31 March 20X6. The rest of the increase in the net assets of Grin Co since acquisition was solely due to profits. Grin Co paid no dividends during this period.

The remaining 52% of the equity of Grin Co at 1 April 20X6 is owned by a few other investors, none of which own more than 10% of the equity of Grin Co.

On 1 April 20X6, Chuckle Co also acquired some share options in Grin Co exercisable any time until 31 March 20X7. The exercise price of the options at 1 April 20X6 was just above the market price of Grin Co's shares. Grin Co has been profitable for a number of years and the share price has been on an upwards trend which is expected to continue. Chuckle Co would increase its ownership to 60% should it exercise its rights. It is believed that there would be additional cost savings should the additional shares be acquired as decisions at board level could be made more efficiently.

Fair value of net assets of Grin Co

The carrying amounts of the net assets of Grin Co on 1 April 20X6 were as follows:

	\$m
Non-current assets	355
Current assets	214
Deferred tax	(16)
Other liabilities	(205)
	—
Total	348
	—

Included within the non-current assets was the land which had been previously revalued upwards by \$15 million on 1 April 20X5. The carrying amount of this land at 1 April 20X5 and 20X6 was \$50 million but its fair value was assessed to be \$60 million at 1 April 20X6.

Current assets include finished goods with a cost of \$84 million. The fair value of these goods is \$131 million.

On 1 April 20X6, the directors of Chuckle Co also identified that Grin Co had an internally generated database of customers who were likely to be interested in purchasing their products. Although there were no contractual or legal rights associated with this database, a professional expert has estimated that competitors of Grin Co would be prepared to pay \$5 million for this database. Grin Co has not recognised the database as an asset within their individual financial statements.

The current rate of tax is 20%. This rate should be applied to any fair value adjustments deemed necessary.

Chuckle Co has a policy of measuring the non-controlling interest as the proportionate share of the net assets.

Required:

Draft an explanatory note to the directors of Chuckle Co to address the following issues:

- (a) (i) why it was correct to initially classify Grin Co as an associate, as opposed to a subsidiary, on 1 April 20X2 (4 marks)
- (ii) how Grin Co should be accounted for as an associate using the equity method in the consolidated statement of financial position of Chuckle Co at 31 March 20X6. Your answer should also explain how the revaluation of the land at 1 April 20X5 was accounted for and include all relevant calculations (5 marks)
- (iii) whether the classification of Chuckle Co's investment in Grin Co should change on April 20X6. (5 marks)

On the assumption that Chuckle Co obtains control on 1 April 20X6, explain:

- (b) (i) how the fair value of the non-current and current assets at acquisition (including any deferred tax adjustments) should be calculated, and (8 marks)
- (ii) how goodwill/gain on bargain purchase should be calculated at 1 April 20X6. Your discussion should include a brief description of the accounting treatment arising from the additional purchase of the 18% equity in Grin Co. (8 marks)

(Total: 30 marks)

2 COLUMBIA (MAR/JUN 2021)



Walk in the footsteps of a top tutor

Background

Columbia Co is the parent of a listed group which operates within the telecommunications industry. During the year ended 31 December 20X5, Columbia Co acquired a new subsidiary and made adjustments to its pension scheme. The group's current year end is 31 December 20X5.

Acquisition of Peru Co

Brazil Co is a competitor of Columbia Co. On 1 July 20X5, both Brazil Co and Columbia Co acquired 50% of the 5 million ordinary \$1 shares of Peru Co. The consideration paid by Columbia Co consisted of cash of \$8 per share and also a 1 for 20 share exchange when the market price of Columbia Co's shares was \$10 each. Brazil Co also paid \$8 per share for their interest but did not issue any shares to the original shareholders of Peru Co. The ordinary shares of Peru Co have one voting right each.

Following the acquisition, Columbia Co had the contractual right to appoint 60% of the board of Peru Co with the remaining 40% appointed by Brazil Co. Brazil Co has veto rights over any amendments to the articles of incorporation and also over the appointment of auditors. Brazil Co and Columbia Co each appointed one member to Peru Co's senior management team. It is the senior manager appointed by Columbia Co who makes the key decisions regarding the development of Peru Co's new technologies, its principle revenue stream, the markets that it will operate in and how it is financed. The senior manager appointed by Columbia Co also provides a supervisory role and has the right to request that significant activities get board approval, such as imposing restrictions on Peru Co from undertaking activities that would significantly increase credit risk.

Peru Co: net assets at 1 July 20X5

The net assets of Peru Co reported in the individual financial statements had a carrying amount of \$32 million on 1 July 20X5. However, on the acquisition of Peru Co, the directors of Columbia Co discovered the following:

On 1 January 20X5, Peru Co acquired 6 million 6% coupon bonds for \$6 million in an unquoted company at par (\$1). Bond interest is paid annually on 31 December. Due to a premium on redemption the effective rate of interest was 8%. Peru Co has a business model to collect the contractual cash-flows from the bonds and therefore measures them at amortised cost. Columbia Co holds similar unquoted assets but has a business model whereby they may either collect the contractual cash-flows or sell the asset. Bonds with a similar risk profile for a similar quoted company were trading at \$2 per bond on 1 July 20X5. A discount of 30% is considered reasonable to reflect the difference in liquidity of the two types of bonds.

One of the identifiable intangible assets of Peru Co at acquisition was a brand. The brand had a carrying amount of \$4 million on 1 July 20X5. Columbia Co has a similar branded product and is, therefore, planning to discontinue the trade of Peru Co's branded product with immediate effect. The future cash-flows from the Peru Co's product post-acquisition are therefore considered to be \$nil. If the trade of the branded product were to be sold to a competitor in order to continue the trade, it is estimated that it could be sold for around \$5 million.

Peru Co has several technical support service contracts for which there are outstanding performance obligations at 1 July 20X5. Included in contract liability (deferred income) at this date is a balance of \$2.8 million in respect of these contracts. It is estimated that these contracts will cost \$1.7 million for Peru Co (and any other market participants) to complete. A mark-up of 30% is considered reasonable for this type of contract.

Columbia Co has a policy of measuring the non-controlling interest at fair value.

Columbia Co: Pension scheme

Columbia Co has, for many years, operated a defined benefit pension scheme. At 1 January 20X5, the fair value of the pension scheme assets were estimated to be \$260 million and the present value of the pension scheme liabilities were \$200 million. The total of the present value of future refunds and reductions in future contributions (asset ceiling) was \$20 million at 1 January 20X5. This table provides details of the scheme for the year ended 31 December 20X5 when there was a curtailment to the scheme.

Discount rate on good quality corporate bonds	5%
	\$m
Current service costs	30
Cash contributions	21
Benefits paid during the year	25
Scheme curtailment (31 December 20X5)	28
Payment to employees as settlement for curtailment (paid 31 December 20X5)	16

At 31 December 20X5, the fair value of the pension scheme assets were estimated to be \$242 million and the present value of the pension scheme liabilities were \$195 million. The total of the present value of future refunds and reductions in future contributions (asset ceiling) was \$25 million at 31 December 20X5.

Columbia Co intends all new employees to be offered a defined contribution rather than a defined benefit pension scheme. Contributions of \$0.5 million were paid into a defined contribution scheme for new employees over the last 3 months of the year.

Required:

Draft an explanatory note to the directors of Columbia Co to address the following issues:

- (a) (i) whether Columbia Co should be considered the acquirer in a business combination with Peru Co (9 marks)
- (ii) a calculation of goodwill at 1 July 20X5, explaining how fair values of both the consideration and the net assets have been determined, and (11 marks)
- (b) how the defined benefit and the defined contribution pension schemes should be accounted for in the year ended 31 December 20X5. (10 marks)

(Total: 30 marks)

3 SUGAR (SEP/DEC 2020) *Walk in the footsteps of a top tutor*

Background

At 30 June 20X7, Sugar Co has investments in several associate companies, including Flour Co. On 1 July 20X7 Sugar Co acquired additional shares in Flour Co and obtained control. On 1 October 20X7 Sugar Co also acquired an associate, Butter Co. The group is preparing the consolidated statement of cash flows for the year ended 30 June 20X8.

Acquisition of Flour Co

Flour Co has 10 million shares in issue. A 40% shareholding in Flour Co was purchased several years ago at a cost of \$10 million. This investment gave Sugar Co significant influence in Flour Co. The consideration to acquire an additional three million shares (30% shareholding) in Flour Co on 1 July 20X7 was in two parts: (i) cash and; (ii) a one for two share exchange when the market price of Sugar Co shares was \$6 each. In Flour Co's individual financial statements, the net assets had increased by \$12 million between the two acquisition dates. The carrying amount of Flour Co's net assets on 1 July 20X7 was as follows: licenses

	\$000
Intangible assets (licenses and patents)	6,781
Property, plant and equipment	18,076
Cash and cash equivalents	1,234
Other net current assets	9,650
	<hr/>
Total net assets carrying amount	35,741
	<hr/>

The carrying amounts of the net assets at 1 July 20X7 were equal to the fair values except for land which had a fair value \$600,000 above the carrying amount. The Sugar group values non-controlling interests (NCI) at fair value and the share price of Flour Co at 1 July 20X7 was \$3.80. This share price should be used to value NCI at that date and to value the initial 40% equity interest in Flour Co.

Goodwill at 1 July 20X7 was correctly calculated as \$2,259,000 and has been correctly accounted for in the consolidated statement of financial position.

Asset acquisitions and disposals

Including its purchase of the additional investment in Flour Co which it correctly consolidated from 1 July 20X7, the Sugar group also purchased various assets during the year.

There were no disposals or impairments of intangible assets during the year but amortisation of \$3.5 million had been deducted from profit from operations.

The only additions to property, plant and equipment during the year were as a result of the acquisition of Flour Co. The group disposed of some plant and machinery at a loss on disposal of \$2 million. Depreciation deducted from the profit from operations was \$10 million.

Sugar Co purchased a 25% equity interest in Butter Co on 1 October 20X7 for \$5 million cash which gave significant influence. Butter Co paid a dividend in the post-acquisition period and Sugar Co also received dividends from other associates during the year ended 30 June 20X8. Sugar Co did not pay any dividends during the year.

There were no acquisitions of investments measured at fair value through profit or loss (FVTPL) during the year but there were disposals which had a carrying amount of \$4 million. These were sold at a profit of \$500,000 which was included, alongside fair value gains, in investment income in the consolidated statement of profit or loss. The investment income figure also includes dividends received from these investments and any fair value gains or losses recognised on the initial investment in Flour Co.

In addition to the shares issued to purchase Flour Co, Sugar Co issued some ordinary \$1 shares for cash during the year ended 30 June 20X8.

Group financial statement extracts

The group's consolidated financial statements have been calculated correctly. Extracts, together with relevant comparative figures at 30 June, are provided below:

Consolidated statement of financial position as at 30 June (extracts):

	20X8 \$000	20X7 \$000
Non-current assets		
Intangible assets	33,456	15,865
Property, plant and equipment	55,124	52,818
Investment in associates	26,328	23,194
Financial assets (measured at FVTPL)	3,000	6,000
Equity		
Ordinary share capital (\$1 shares)	23,000	20,000
Other components of equity (all share premium)	33,600	18,000
Non-controlling interest	30,152	12,914

Consolidated statement of profit or loss for the year ended 30 June 20X8 (extract):

	\$000
Investment income	3,891
Share of profit from associate companies	15,187
Profit attributable to the non-controlling interest	9,162

Pension scheme

Sugar Co is the only entity of the group which operates a defined benefit pension scheme. The pension scheme obligation increased during the year from \$1.175m to \$6.368m. The movement on the pension liability represents the service cost component, the net interest component and also the remeasurement component for the year. Sugar Co usually makes cash contributions into the scheme on an annual basis towards the year end. The significant increase in the pension scheme obligation for the year ended 30 June 20X8 was because the contributions to the scheme did not follow normal practice and were instead made in July 20X8. Benefits paid during the year were \$2 million in cash.

Required:

- (a) Draft an explanatory note to the directors of Sugar Co, addressing how the initial 40% investment in Flour Co and the additional purchase of the equity shares on 1 July 20X7 should be accounted for in the consolidated financial statements (including the statement of cash flows). Using the goodwill figure of \$2,259,000, calculate the cash paid to acquire control of Flour Co and include a brief explanation as to how that cash should be accounted for in the consolidated statement of cash flows.

(10 marks)

- (b) Prepare extracts of the cash flows generated from (i) investing activities and (ii) financing activities in the consolidated statement of cash flows for the Sugar group for the year ended 30 June 20X8. No explanations are required in part (b).

(16 marks)

- (c) Describe the impact, if any, that the defined benefit pension scheme will have on the consolidated statement of cash flows for the Sugar group for the year ended 30 June 20X8 assuming that cash flows from operating activities are calculated by the indirect method.

(4 marks)

(Total: 30 marks)

4 HUMMINGS (MAR 2020) *Walk in the footsteps of a top tutor*

Background

Humming Co is the parent company of a multinational listed group of companies. Humming Co uses the dollar (\$) as its functional currency. Humming Co acquired 80% of the equity shares of Crotchet Co on 1 January 20X4 and 100% of Quaver Co on the same date. The group's current financial year end is 31 December 20X4.

Crotchet Co: functional currency

The head office of Crotchet Co is located in a country which uses the dinar as its main currency. However, its staff are located in a variety of other locations. Consequently, half of their employees are paid in dinars and the other half are paid in the currency of grommits. Crotchet Co has a high degree of autonomy and is not reliant on finance from Humming Co, nor do sales to Humming Co make up a significant proportion of their income. All of its sales and purchases are invoiced in grommits and therefore Crotchet Co raises most of its finance in grommits. Cash receipts are retained in both grommits and dinars. Crotchet Co does not own a dollar (\$) bank account. Crotchet Co is required by law to pay tax on its profits in dinars.

The acquisition of Crotchet Co

Humming Co paid cash of \$24 million for the 80% holding in Crotchet Co on 1 January 20X4. Humming Co has a policy of measuring non-controlling interests at fair value. The fair value of the non-controlling interests in Crotchet Co on 1 January 20X4 was \$6 million. Since Crotchet Co has a range of net assets held domestically and overseas, the fair values of the net assets at acquisition were determined in their local currency. Hence, the fair value of some assets have been determined in dinars and others in grommits. The total fair value of the net assets denominated in grommits at 1 January 20X4 was 43 million grommits. The total fair value of the net assets denominated in dinars at 1 January 20X4 was 50 million dinars.

Excluded from these fair values are several contracts with the customers of Crotchet Co. These contractual relationships prohibit the customers of Crotchet Co from obtaining services from any of the main competitors of Crotchet Co. They have an estimated fair value at 1 January 20X4 of 15 million grommits.

At 31 December 20X4, it was decided to impair goodwill by 30%.

The following is a summary of the exchange rates between the dollar, grommits and dinars at 1 January 20X4 and 31 December 20X4:

1 January 20X4	31 December 20X4
\$1:8 grommits	\$1:7 grommits
\$1: 4 dinar	\$1: 3.5 dinar
1 dinar:2 grommits	1 dinar:2 grommits

The acquisition of Quaver Co

On 1 January 20X4, Hummings Co purchased a 100% equity interest in Quaver Co. Hummings Co made the acquisition with the intention to sell and therefore did not wish to have an active involvement in the business of Quaver Co. Hummings Co immediately began to seek a buyer for Quaver Co and felt that the sale would be completed by 31 October 20X4 at the latest. A buyer for Quaver Co was located in August 20X4 but, due to an unforeseen legal dispute over a contingent liability disclosed in Quaver Co's financial statements, the sale had not yet been finalised as at 31 December 20X4. The sale is expected to be completed in early 20X5.

Impairment of bonds

On 31 December 20X3, Hummings Co purchased \$10 million 5% bonds in Stave Co at par value. The bonds are repayable on 31 December 20X6 and the effective rate of interest is 8%. Hummings Co's business model is to collect the contractual cash flows over the life of the asset. At 31 December 20X3, the bonds were considered to be low risk and as a result the 12-month expected credit losses are expected to be \$10,000.

On 31 December 20X4, Stave Co paid the coupon interest. However, at that date, the risks associated with the bonds were deemed to have increased significantly. The present value of the cash shortfalls arising on default in the year ended 31 December 20X5 is \$462,963 and the probability of default is 3%. The present value of cash shortfalls arising on default in the year ended 31 December 20X6 is \$6,858,710 and the probability of default is 5%.

Required:

Draft an explanatory note to the directors of Hummings Co, addressing the following:

- (a) how the functional currency of Crotchet Co should be determined. (5 marks)**
- (b) (i) how Crotchet Co's customer contracts should be accounted for in the consolidated financial statements of Hummings Co, which are presented in dollars (\$), for the year ended 31 December 20X4. (4 marks)**
 - (ii) a calculation of the goodwill on acquisition of Crotchet Co (in grommits) and how it would be accounted for in the consolidated statement of financial position of Hummings Co at 31 December 20X4 after translation. Include a brief explanation and calculation of how the impairment and exchange difference on goodwill will impact on the consolidated financial statements. (6 marks)**
- (c) how Quaver Co should be accounted for in the consolidated financial statements at 31 December 20X4. (4 marks)**
- (d) a calculation and discussion of how the bonds should be accounted for in the financial statements of Hummings Co as at 31 December 20X3 and for the year ended 31 December 20X4, including any impairment losses. (11 marks)**

(Total: 30 marks)

5 LUPLOID (SEP/DEC 2019)

*Walk in the footsteps of a top tutor***Background**

Luploid Co is the parent company of a group undergoing rapid expansion through acquisition. Luploid Co has acquired two subsidiaries in recent years, Colyson Co and Hammond Co. The current financial year end is 30 June 20X8.

Acquisition of Colyson Co

Luploid Co acquired 80% of the five million equity shares (\$1 each) of Colyson Co on 1 July 20X4 for cash of \$90 million. The fair value of the non-controlling interest (NCI) at acquisition was \$22 million. The fair value of the identifiable net assets at acquisition was \$65 million, excluding the following asset. Colyson Co purchased a factory site several years prior to the date of acquisition. Land and property prices in the area had increased significantly in the years immediately prior to 1 July 20X4. Nearby sites had been acquired and converted into residential use. It is felt that, should the Colyson Co site also be converted into residential use, the factory site would have a market value of \$24 million. \$1 million of costs are estimated to be required to demolish the factory and to obtain planning permission for the conversion. Colyson Co was not intending to convert the site at the acquisition date and had not sought planning permission at that date. The depreciated replacement cost of the factory at 1 July 20X4 has been correctly calculated as \$17.4 million.

Impairment of Colyson Co

Colyson Co incurred losses during the year ended 30 June 20X8 and an impairment review was performed. The carrying amount of the net assets of Colyson Co at 30 June 20X8 (including fair value adjustments on acquisition but excluding goodwill) are as follows:

	\$m
Land and buildings	60
Plant and machinery	15
Intangibles other than goodwill	9
Current assets (at recoverable amount)	22
	—
Total	106
	—

The recoverable amount of Colyson Co's assets was estimated to be \$100 million. Included in this assessment was a building owned by Colyson Co which had been damaged in a storm and needs to be impaired by \$4 million. Other land and buildings are held at recoverable amount. None of the assets of Colyson Co including goodwill have been impaired previously. Colyson Co does not have a policy of revaluing its assets.

Acquisition of Hammond Co and share-based payments

Luploid Co acquired 60% of the 10 million equity shares of Hammond Co on 1 July 20X7. Two Luploid Co shares are to be issued for every five shares acquired in Hammond Co. These shares will be issued on 1 July 20X8. The fair value of a Luploid Co share was \$30 at 1 July 20X7.

Hammond Co had previously granted a share-based payment to its employees with a three-year vesting period. At 1 July 20X7, the employees had completed their service period but had not yet exercised their options. The fair value of the options granted at 1 July 20X7 was \$15 million. As part of the acquisition, Luploid Co is obliged to replace the share-based payment scheme of Hammond Co with a scheme that has a fair value of \$18 million at 1 July 20X7. There are no vesting conditions attached to this replacement scheme.

Unrelated to the acquisition of Hammond, Luploid Co issued 100 options to 10,000 employees on 1 July 20X7. The shares are conditional on the employees completing a further two years of service. Additionally, the scheme required that the market price of Luploid Co's shares had to increase by 10% from its value of \$30 per share at the acquisition date over the vesting period. It was anticipated at 1 July 20X7 that 10% of staff would leave over the vesting period but this was revised to 4% by 30 June 20X8. The fair value of each option at the grant date was \$20. The share price of Luploid Co at 30 June 20X8 was \$32 and is anticipated to grow at a similar rate in the year ended 30 June 20X9.

Required:

Draft an explanatory note to the directors of Luploid Co, addressing the following:

- (a) (i) How the fair value of the factory site should be determined at 1 July 20X4 and why the depreciated replacement cost of \$17.4 million is unlikely to be a reasonable estimate of fair value. (7 marks)
- (ii) A calculation of goodwill arising on the acquisition of Colyson Co measuring the non-controlling interest at:
 - fair value
 - proportionate share of the net assets. (3 marks)
- (b) The calculation and allocation of Colyson Co's impairment loss at 30 June 20X8 and a discussion of why the impairment loss of Colyson Co would differ depending on how non-controlling interests are measured. Your answer should include a calculation and an explanation of how the impairments would impact upon the consolidated financial statements of Luploid Co. (11 marks)
- (c) (i) How the consideration for the acquisition of Hammond Co should be measured on 1 July 20X7. Your answer should include a discussion of why only some of the cost of the replacement share-based payment scheme should be included within the consideration. (4 marks)
- (ii) How much of an expense for share-based payment schemes should be recognised in the consolidated statement of profit or loss of Luploid Co for the year ended 30 June 20X8. Your answer should include a brief discussion of the relevant principles and how the vesting conditions impact upon the calculations. (5 marks)

Note: Any workings can either be shown in the main body of the explanatory note or in an appendix to the explanatory note.

(Total: 30 marks)

6 CARBISE (MAR/JUN 2019) *Walk in the footsteps of a top tutor*

Background

Carbise is the parent company of an international group which has a presentation and functional currency of the dollar. The group operates within the manufacturing sector. On 1 January 20X2, Carbise acquired 80% of the equity share capital of Bikelite, an overseas subsidiary. The acquisition enabled Carbise to access new international markets. Carbise transfers surplus work-in-progress to Bikelite which is then completed and sold in various locations. The acquisition was not as successful as anticipated and on 30 September 20X6 Carbise disposed of all of its holding in Bikelite. The current year end is 31 December 20X6.

Bikelite trading information

Bikelite is based overseas where the domestic currency is the dinar. Staff costs and overhead expenses are all paid in dinars. However, Bikelite also has a range of transactions in a number of other currencies. Approximately 40% of its raw material purchases are in dinars and 50% in the yen. The remaining 10% are in dollars of which approximately half were purchases of material from Carbise. This ratio continued even after Carbise disposed of its shares in Bikelite.

Revenue is invoiced in equal proportion between dinars, yen and dollars. To protect itself from exchange rate risk, Bikelite retains cash in all three currencies. No dividends have been paid by Bikelite for several years. At the start of 20X6 Bikelite sought additional debt finance. As Carbise was already looking to divest, funds were raised from an issue of bonds in dinars, none of which were acquired by Carbise.

Acquisition of Bikelite

Carbise paid dinar 100 million for 80% of the ordinary share capital of Bikelite on 1 January 20X2. The net assets of Bikelite at this date had a carrying amount of dinar 60 million. The only fair value adjustment deemed necessary was in relation to a building which had a fair value of dinar 20 million above its carrying amount and a remaining useful life of 20 years at the acquisition date. Carbise measures non-controlling interests (NCI) at fair value for all acquisitions, and the fair value of the 20% interest was estimated to be dinar 22 million at acquisition. Due to the relatively poor performance of Bikelite, it was decided to impair goodwill by dinar 6 million during the year ending 31 December 20X5.

Rates of exchange between the \$ and dinar are given as follows:

1 January 20X2:	\$1:0.5 dinar
Average rate for year ended 31 December 20X5	\$1:0.4 dinar
31 December 20X5:	\$1:0.38 dinar
30 September 20X6:	\$1:0.35 dinar
Average rate for the nine-month period ended 30 September 20X6	\$1:0.37 dinar

Disposal of Bikelite

Carbise sold its entire equity shareholding in Bikelite on 30 September 20X6 for \$150 million. Further details relating to the disposal are as follows:

Carrying amount of Bikelite's net assets at 1 January 20X6 in its separate financial statements	dinar 48 million
Bikelite loss for the year ended 31 December 20X6 in its separate financial statements	dinar 8 million
Cumulative exchange gains on Bikelite at 1 January 20X6	\$74.1 million
Non-controlling interest in Bikelite at 1 January 20X6	\$47.8 million

Required:

- (a) Prepare an explanatory note for the directors of Carbise which addresses the following issues:
- (i) The meaning of an entity's presentation and functional currency Explain your answer with reference to how the presentation and functional currency of Bikelite should be determined. (7 marks)
 - (ii) A calculation of the goodwill on the acquisition of Bikelite and what the balance would be at 30 September 20X6 immediately before the disposal of the shares. Your answer should include a calculation of the exchange difference on goodwill for the period from 1 January 20X6 to 30 September 20X6. (5 marks)
 - (iii) An explanation of your calculation of goodwill and the treatment of exchange differences on goodwill in the consolidated financial statements. You do not need to discuss how the disposal will affect the exchange differences. (4 marks)

Note: Any workings can either be shown in the main body of the explanatory note or in an appendix to the explanatory note.

- (b) Explain why exchange differences will arise on the net assets and profit or loss of Bikelite each year and how they would be presented within the consolidated financial statements. Your answer should include a calculation of the exchange differences which would arise on the translation of Bikelite (excluding goodwill) in the year ended 31 December 20X6. (7 marks)
- (c) (i) Calculate the group profit or loss on the disposal of Bikelite. (3 marks)
- (ii) Briefly explain how Bikelite should be treated and presented in the consolidated financial statements of Carbise for the year ended 31 December 20X6. (4 marks)

(Total: 30 marks)

7 MOYES (DEC 2018) *Walk in the footsteps of a top tutor*

Background

The following are extracts from the consolidated financial statements of the Moyes group.

Group statement of profit or loss for the year ended 30 September 20X8:

	\$m
Revenue	612
Cost of sales	(347)
	—
Gross profit	265
Operating expenses	(123)
Share of profit of associate	67
	—
Profit before tax	209
	—

Extracts from the group statement of financial position:

	30 September 20X8	30 September 20X7
	\$m	\$m
Inventories	126	165
Trade receivables	156	149
Trade payables	215	197

The following information is also relevant to the year ended 30 September 20X8:

Pension scheme

Moyes operates a defined benefit scheme. A service cost component of \$24 million has been included within operating expenses. The remeasurement component for the year was a gain of \$3 million. Benefits paid out of the scheme were \$31 million. Contributions into the scheme by Moyes were \$15 million.

Goodwill

Goodwill was reviewed for impairments at the reporting date. Impairments arose of \$10 million in the current year.

Property, plant and equipment

Property, plant and equipment (PPE) at 30 September 20X8 included cash additions of \$134 million. Depreciation charged during the year was \$99 million and an impairment loss of \$43 million was recognised. Prior to the impairment, the group had a balance on the revaluation surplus of \$50 million of which \$20 million related to PPE impaired in the current year.

Inventory

Goods were purchased for Dinar 80 million cash when the exchange rate was \$1:Dinar 5. Moyes had not managed to sell the goods at 30 September 20X8 and the net realisable value was estimated to be Dinar 60 million at 30 September 20X8. The exchange rate at this date was \$1:Dinar 6. The inventory has been correctly valued at 30 September 20X8 with any expense correctly included within cost of sales.

Changes to group structure

During the year ended 30 September 20X8, Moyes acquired a 60% subsidiary, Davenport, and also sold all of its equity interests in Barham for cash. The consideration for Davenport consisted of a share for share exchange together with some cash payable in two years. 80% of the equity shares of Barham had been acquired several years ago but Moyes had decided to sell as the performance of Barham had been poor for a number of years. Consequently, Barham had a substantial overdraft at the disposal date. Barham was unable to pay any dividends during the financial year but Davenport did pay an interim dividend on 30 September 20X8.

Discontinued operations

The directors of Moyes wish advice as to whether the disposal of Barham should be treated as a discontinued operation and separately disclosed within the consolidated statement of profit or loss. There are several other subsidiaries which all produce similar products to Barham and operate in a similar geographical area. Additionally, Moyes holds a 52% equity interest in Watson. Watson has previously issued share options to other entities which are exercisable in the year ending 30 September 20X9. It is highly likely that these options would be exercised which would reduce Moyes' interest to 35%. The directors of Moyes require advice as to whether this loss of control would require Watson to be classified as held for sale and reclassified as discontinued.

Required:

- (a) Draft an explanatory note to the directors of Moyes which should include:
- (i) a calculation of cash generated from operations using the indirect method; and
 - (ii) an explanation of the specific adjustments required to the group profit before tax to calculate the cash generated from operations.

Note: Any workings can either be shown in the main body of the explanatory note or in an appendix to the explanatory note. (12 marks)

- (b) Explain how the changes to the group structure and dividend would impact upon the consolidated statement of cash flows at 30 September 20X8 for the Moyes group. You should not attempt to alter your answer to part (a). (6 marks)
- (c) Advise the directors as to whether Watson should be classified as held for sale and whether both it and Barham should be classified as discontinued operations. (6 marks)
- (d) The recognition criteria in the 2010 *Conceptual Framework* stated that a flow of economic benefits must be probable before an element can be recognised in the financial statements. However, IFRS and IAS Standards were criticised for applying this probability criterion inconsistently. The 2018 *Conceptual Framework* addressed these concerns.

Required:

Explain how the probability criterion has been inconsistently applied across accounting standards. Illustrate your answer with reference to the measurement of assets held for sale, provisions, and contingent consideration transferred in a business combination. Your answer should discuss the Board's recognition criteria in the 2018 *Conceptual Framework*. (6 marks)

(Total: 30 marks)

8 BANANA (SEP 2018) *Walk in the footsteps of a top tutor*



Answer debrief

Background

Banana is the parent of a listed group of companies which have a year end of 30 June 20X7. Banana has made a number of acquisitions and disposals of investments during the current financial year and the directors require advice as to the correct accounting treatment of these acquisitions and disposals.

The acquisition of Grape

On 1 January 20X7, Banana acquired an 80% equity interest in Grape. The following is a summary of Grape's equity at the acquisition date.

	\$m
Equity share capital (\$1 each)	20
Retained earnings	42
Other components of equity	8
	—
Total	70
	—

The purchase consideration comprised 10 million of Banana's shares which had a nominal value of \$1 each and a market price of \$6.80 each. Additionally, cash of \$18 million was due to be paid on 1 January 20X9 if the net profit after tax of Grape grew by 5% in each of the two years following acquisition. The present value of the total contingent consideration at 1 January 20X7 was \$16 million. It was felt that there was a 25% chance of the profit target being met. At acquisition, the only adjustment required to the identifiable net assets of Grape was for land which had a fair value \$5 million higher than its carrying amount. This is not included within the \$70 million equity of Grape at 1 January 20X7.

Goodwill for the consolidated financial statements has been incorrectly calculated as follows:

	\$m
Share consideration	68
Add NCI at acquisition (20% × \$70 million)	14
Less net assets at acquisition	(70)
	—
Goodwill at acquisition	12
	—

The financial director did not take into account the contingent cash since it was not probable that it would be paid. Additionally, he measured the non-controlling interest using the proportional method of net assets despite the group having a published policy to measure non-controlling interest at fair value. The share price of Grape at acquisition was \$4.25 and should be used to value the non-controlling interest.

The acquisition and subsequent disposal of Strawberry

Banana had purchased a 40% equity interest in Strawberry for \$18 million a number of years ago when the fair value of the identifiable net assets was \$44 million. Since acquisition, Banana had the right to appoint one of the five directors on the board of Strawberry. The investment has always been equity accounted for in the consolidated financial statements of Banana.

Banana disposed of 75% of its 40% investment on 1 October 20X6 for \$19 million when the fair values of the identifiable net assets of Strawberry were \$50 million. At that date, Banana lost its right to appoint one director to the board. The fair value of the remaining 10% equity interest was \$4.5 million at disposal but only \$4 million at 30 June 20X7. Banana has recorded a loss in reserves of \$14 million calculated as the difference between the price paid of \$18 million and the fair value of \$4 million at the reporting date. Banana has stated that they have no intention to sell their remaining shares in Strawberry and wish to classify the remaining 10% interest as fair value through other comprehensive income in accordance with IFRS 9 *Financial Instruments*.

The acquisition of Melon

On 30 June 20X7, Banana acquired all of the shares of Melon, an entity which operates in the biotechnology industry. Melon was only recently formed and its only recognised asset consists of a licence to carry out research activities. Melon has no employees because research activities were outsourced to other companies, although these contracts expired on 30 June 20X7. The research activities are still at a very early stage and it is not clear whether any definitive product would result from the activities. A management company provides personnel for Melon to supply supervisory activities and administrative functions. Banana believes that Melon does not constitute a business in accordance with IFRS 3 *Business Combinations*. The directors of Banana believe that Melon should be treated as an asset acquisition.

The acquisition of bonds

On 1 July 20X5, Banana acquired \$10 million 5% bonds at par with interest being due at 30 June each year. The bonds are repayable at a substantial premium so that the effective rate of interest was 7%. Banana intended to hold the bonds to collect the contractual cash flows arising from the bonds and measured them at amortised cost.

On 1 July 20X6, Banana sold the bonds to a third party for \$8 million. The fair value of the bonds was \$10.5 million at that date. Banana has the right to repurchase the bonds on 1 July 20X8 for \$8.8 million and it is likely that this option will be exercised. The third party is obliged to return the coupon interest to Banana and to pay additional cash to Banana should bond values rise. Banana will also compensate the third party for any devaluation of the bonds.

Required:

- (a) Draft an explanatory note to the directors of Banana, discussing the following:
 - (i) how goodwill should have been calculated on the acquisition of Grape and show the accounting entry which is required to amend the financial director's error (8 marks)
 - (ii) why equity accounting was the appropriate treatment for Strawberry in the consolidated financial statements up to the date of its disposal showing the carrying amount of the investment in Strawberry just prior to disposal (4 marks)
 - (iii) how the gain or loss on disposal of Strawberry should have been recorded in the consolidated financial statements and how the investment in Strawberry should be accounted for after the part disposal. (4 marks)

Note: Any workings can either be shown in the main body of the explanatory note or in an appendix to the explanatory note.
- (b) Discuss whether the directors are correct to treat Melon as an asset acquisition. (7 marks)
- (c) Discuss how the derecognition requirements of IFRS 9 *Financial Instruments* should be applied to the sale of the bond including calculations to show the impact on the consolidated financial statements for the year ended 30 June 20X7. (7 marks)

(Total: 30 marks)



Calculate your allowed time, allocate the time to the separate parts.....

9

BUBBLE

*Walk in the footsteps of a top tutor***Background**

The following extracts from draft financial statements relate to Bubble, a public limited company, and Tyslar, a company in which it has an investment.

Extracts from draft statements of financial position as at 31 October 20X5

	Bubble \$m	Tyslar Dinars m
Assets		
Non-current assets		
Property, plant and equipment	280	390
Investment in Tyslar	46	–
Financial assets	122	98
	<hr/>	<hr/>
Total non-current assets	448	488
	<hr/>	<hr/>
Equity		
Equity shares (\$1 each)	80	210
Retained earnings	230	292
Other components of equity	40	–
	<hr/>	<hr/>
Total equity	350	502
	<hr/>	<hr/>

The following information is relevant to the preparation of the consolidated statement of financial position as at 31 October 20X5.

Tyslar

Bubble owns 60% of the equity shares of Tyslar, a company located overseas which has presented its financial statements in dinars. The shares in Tyslar were acquired on 1 November 20X4.

At the date of acquisition, retained earnings were 258 million dinars and Tyslar had no other components of equity. On this date, non-depreciable land was carried in the financial statements of Tyslar at 50 million dinars but it had a fair value of 70 million dinars.

The non-controlling interest at acquisition is to be calculated at fair value by reference to the quoted share price of Tyslar. At the acquisition date, the quoted share price was 2.62 dinars per share.

An impairment review of goodwill was undertaken as at 31 October 20X5. The goodwill of Tyslar is to be impaired by 20%. Tyslar has not issued any equity shares since acquisition.

The following exchange rates have been provided:

	Dinars to \$
1 November 20X4	8
1 May 20X5	9
31 October 20X5	9.5
Average for the year to 31 October 20X5	8.5

Overseas property

Bubble wished to expand its overseas operations and on 1 May 20X5 acquired an overseas property with a fair value of 58.5 million dinars. In exchange for the building, Bubble paid the supplier with land which Bubble had held but for which it had yet to determine its use. The carrying amount of the land was \$5 million but it had an open market value of \$7 million. Bubble was unsure as to how to deal with this transaction and so has transferred \$5 million from investment properties to property, plant and equipment. The transaction has commercial substance.

In addition, Bubble spent \$0.5 million to help relocate staff to the new property and added this amount to the cost of the building. Bubble has made no other entries in its financial statements in relation to the property. Bubble has a policy of depreciating properties over 35 years and follows the revaluation model under IAS 16 *Property, Plant & Equipment*. As a result of a surge in the market, it is estimated that the fair value of the property is 75 million dinars as at 31 October 20X5.

Required:

- (a) (i) Calculate, with supporting explanations, the value of goodwill arising on the acquisition of Tyslar that should be reported in the consolidated statement of financial position as at 31 October 20X5. (7 marks)
- (ii) Explain why foreign exchange differences arise on the retranslation of Tyslar and how they are accounted for in the consolidated financial statements. As part of your answer you should calculate the balance on the group translation reserve as at 31 October 20X5. (10 marks)
- (iii) Advise the directors of Bubble on how to correct the accounting treatment of the overseas property, showing the adjustments needed, and calculate the 'property, plant and equipment' balance as it would appear in the consolidated statement of financial position as at 31 October 20X5. (7 marks)
- (b) **Functional currency**

Tyslar operates a mine. Its income is denominated and settled in dinars. The output of the mine is routinely traded in dinars and its price is determined initially by local supply and demand. Tyslar pays 40% of its costs and expenses in dollars with the remainder being incurred locally and settled in dinars. Tyslar's management has a considerable degree of authority and autonomy in carrying out the operations of Tyslar and is not dependent upon group companies for finance.

Required:

Discuss and apply the principles set out in IAS 21 *The Effects of Changes in Foreign Exchange Rates* in order to determine the functional currency of Tyslar. (6 marks)

(Total: 30 marks)

10 JOCATT *Walk in the footsteps of a top tutor*

Background

The following draft group financial statements relate to Jocatt, a public limited company, with a reporting date of 30 November 20X2.

Jocatt Group: Extracts from statement of financial position as at 30 November

	20X2 \$m	20X1 \$m
Non-current assets		
Property, plant and equipment	502	412
Investment property	8	6
Goodwill	40	68
Financial assets	4	–
Current assets		
Inventories	105	128
Trade receivables	62	113
Non-current liabilities:		
Long-term borrowings	67	71
Deferred tax	32	41
Defined benefit pension deficit	25	22
Current liabilities:		
Trade payables	144	55
Current tax payable	33	30

Jocatt Group: Extract from statement of profit or loss and other comprehensive income for the year ended 30 November 20X2

	\$m
Profit from operations	52
Finance costs	(8)
	<hr/>
Profit before tax	44
Income tax expense	(11)
	<hr/>
Profit for the year	34
	<hr/>
Other comprehensive income after tax – items that will not be reclassified to profit or loss in future accounting periods:	
Changes in revaluation surplus (PPE)	(4)
Net remeasurement gain on defined benefit plan	8
Tax on the above	(1)
	<hr/>
Other comprehensive income for the year	3
	<hr/>

Jocatt Group: Statement of changes in equity for the year ended 30 November 20X2

	Share capital	Retained earnings	Revaluation surplus (PPE)	Total	Non- controlling interest	Total equity
	\$m	\$m	\$m	\$m	\$m	\$m
Balance at 1 Dec 20X1	275	328	16	619	36	655
Share capital issued	15			15		15
Dividends		(5)		(5)	(11)	(16)
Acquisitions					20	20
Total comp inc for year		30	(3)	27	10	37
Balance at 30 Nov 20X2	290	353	13	656	55	711

Additional information

The following information relates to the financial statements of Jocatt:

- On 1 December 20X1, Jocatt acquired 8% of the ordinary shares of Tigret for \$4 million and recorded it as a financial asset at the cost of purchase. This investment was measured at fair value through profit or loss.

On 30 June 20X2, Jocatt acquired a further 52% of the ordinary shares of Tigret and gained control of the company. The purchase consideration transferred on 30 June 20X2 comprised cash of \$15 million and shares of \$15 million. The fair value of the non-controlling interest in Tigret on 30 June 20X2 was correctly determined to be \$20 million. The fair value of Tigret's identifiable net assets at the acquisition date, excluding deferred tax, was \$45 million and included:

	\$m
Trade receivables	5
Trade payables	6

Jocatt has calculated and accounted for goodwill arising on the acquisition of Tigret of \$5 million (\$30m + \$20m – \$45 million). However, the following has not been taken into account:

- At 30 June 20X2, the fair value of the 8% holding in Tigret had risen to \$5 million. In the consolidated statement of financial position as at 30 November 20X2, this investment is still classified as a financial asset and is measured at \$4 million.
 - The tax base of the identifiable net assets of Tigret was \$35 million at 30 June 20X2. The tax rate of Tigret is 30%.
- Goodwill relating to all subsidiaries had been impairment tested in the year to 30 November 20X2 and any impairment correctly calculated and accounted for.
 - Jocatt operates a defined benefit scheme. The service cost component for the year ended 30 November 20X2 is \$16 million. The net interest component of \$2 million is included within finance costs.
 - Jocatt uses the fair value model for measuring investment property. No investment properties have been purchased or sold in the current period.
 - Jocatt sold property, plant and equipment with a carrying amount of \$10 million for cash of \$19 million. Depreciation for the period was \$27 million.

Required:

- (a) (i) Discuss, with calculations, how goodwill arising on the acquisition of Tigret should have been calculated. Show the adjustments which need to be made to the consolidated financial statements. (7 marks)
- (ii) In accordance with IAS 7 *Statement of Cash Flows*, prepare:
- Cash flows from operating activities (using the indirect method)
 - Cash flows from financing activities.

Note: Ignore deferred taxation other than where it is mentioned in the question. (17 marks)

(b) Direct and indirect methods

The directors of Jocatt have commented that the indirect method of reporting cash flows from operating activities is more useful and informative to users of financial statements than the direct method.

Required:

Discuss the extent to which the directors' comment is valid. (6 marks)

(Total: 30 marks)

11 ZIPPY Walk in the footsteps of a top tutor

Background

Zippy is a manufacturing company with a reporting date of 30 June 20X6. It has a wide portfolio of investment properties, as well as investments in many other entities. The draft statement of profit or loss and other comprehensive income for one of those entities, Ginny, is provided below

Draft statement of profit or loss and other comprehensive income for the year ended 30 June 20X6

	\$m
Revenue	132
Cost of sales	(76)
	<hr/>
Gross profit	56
Investment income	19
Administrative costs	(12)
Other expenses	(18)
	<hr/>
Operating profit	45
Net finance costs	(6)
	<hr/>
Profit before tax	39
Income tax expense	(7)
	<hr/>
Profit for the year	32
	<hr/>

	\$m
Other comprehensive income	
Items that will not be reclassified to profit or loss	
Gains on property revaluation	16
	<hr/>
Total comprehensive income for year	48
	<hr/>

The following information is relevant to the preparation of the group statement of profit or loss and other comprehensive income:

Ginny

On 1 July 20X4, Zippy acquired 60% of the equity interests of Ginny, a public limited company. The purchase consideration comprised cash of \$90 million and the fair value of the identifiable net assets acquired was \$114 million at that date. Zippy uses the 'full goodwill' method for all acquisitions and the fair value of the non-controlling interest in Ginny was \$50 million on 1 July 20X4. Goodwill had been reviewed annually for impairment and no impairment was deemed necessary.

Zippy disposed of a 20% equity interest in Ginny on 31 March 20X6 for cash consideration of \$44 million. On the disposal date the remaining 40% holding had a fair value of \$62 million and Zippy was left with significant influence over Ginny. Zippy accounts for investments in subsidiaries at cost and has included a gain in investment income of \$14 million within its individual financial statements to reflect the disposal. The net assets of Ginny had a fair value of \$118 million at 1 July 20X5 and this was reflected in the carrying amounts of the net assets. All gains and losses of Ginny have accrued evenly throughout the year. The disposal is not classified as a separate major line of business or geographical operation.

Office blocks

Zippy holds properties for investment purposes. At 1 July 20X5, Zippy held a 10-floor office block at a fair value of \$90 million with a remaining useful life of 15 years. The first floor was occupied by Zippy's staff and the second floor was let to Boo, a subsidiary of Zippy, free of charge. The other eight floors were all let to unconnected third parties at a normal commercial rent. When Boo vacates the property next year, it will be let out to third parties. It was estimated that the fair value of the office block was \$96 million at 30 June 20X6. Zippy has a policy of restating all land and buildings to fair value at each reporting date. The only accounting entries for the year ended 30 June 20X6 in relation to this office block have been to correctly include the rental income in profit or loss. It can be assumed that each floor is of equal size and value. Depreciation is charged to administrative costs.

During April 20X6, an explosion at a different office block caused substantial damage and it was estimated that the fair value fell from \$20 million at 30 June 20X5 to \$14 million at 30 June 20X6. Zippy has estimated that costs of \$3 million would be required to repair the block but is unsure whether to carry out the repairs or whether to sell the block for a reduced price. The property has been left in the financial statements at a value of \$20 million. A provision of \$3 million for the repair costs was charged to other expenses.

Required:

- (a) (i) Explain, with suitable calculations, how the investment in Ginny should be accounted for in the consolidated statement of profit or loss and other comprehensive income of the Zippy group for the year ended 30 June 20X6. (11 marks)
- (ii) Explain, with suitable calculations, how the two office blocks should be accounted for in the consolidated financial statements of the Zippy group for the year ended 30 June 20X6. (8 marks)
- (iii) Explain why the accounting treatment of the 10 floor office block in Zippy's individual (non-consolidated) financial statements will differ from the treatment in the consolidated financial statements of the Zippy group. Calculations are not required. (4 marks)
- (b) Other comprehensive income

The directors of Zippy are unsure as to the differences between other comprehensive income and profit or loss and the rationale as to why some gains can be and others cannot be reclassified to profit or loss. Zippy has a defined benefit pension scheme and the directors have heard that local GAAP in some countries allows actuarial gains and losses (the remeasurement component) to be deferred using an applicable systematic method rather than being recognised immediately.

Required:

Discuss the differences between other comprehensive income and profit or loss and the rationale as to why some gains and losses can be and others cannot be reclassified to profit or loss. Include in your answer a brief discussion of the benefits of immediate recognition of the remeasurement component under IAS 19 *Employee Benefits*. (7 marks)

(Total: 30 marks)

12 ASHANTI

Background

The following financial statement extracts relate to Ashanti, a public limited company, and its investments.

Extracts from the statements of profit or loss for the year ended 30 April 20X9.

	Ashanti	Bochem	Ceram
	\$m	\$m	\$m
Revenue	810	235	142
Cost of sales	(686)	(137)	(84)
	—	—	—
Gross profit	124	98	58
	—	—	—

The following information is relevant to the preparation of the group statement of profit or loss.

Sale of shares in Bochem

On 1 May 20X7, Ashanti acquired 70% of the equity interests of Bochem, a public limited company. The fair value of the identifiable net assets at that date was \$160 million. The share capital and retained earnings of Bochem were \$55 million and \$85 million respectively and other components of equity were \$10 million at the date of acquisition. The excess of the fair value of the identifiable net assets at acquisition is due to an increase in the value of plant, which is depreciated on the straight-line method and has a five year remaining life at the date of acquisition. Depreciation is charged to cost of sales.

Ashanti disposed of a 10% equity interest to the non-controlling interests (NCI) of Bochem on 30 April 20X9 for a cash consideration of \$34 million. The carrying amount of the net assets of Bochem at 30 April 20X9 was \$210 million before any adjustments on consolidation. Goodwill arising on the acquisition of Bochem was \$44 million but had reduced in value by 20% before the sale of the equity interest to the NCI.

Sale of shares in Ceram

Ashanti acquired 80% of the equity interests of Ceram, a public limited company, on 1 May 20X7. The purchase consideration was cash of \$95.2 million. Ceram's identifiable net assets were fair valued at \$115 million and the NCI of Ceram had a fair value of \$26 million at that date. On 1 November 20X8, Ashanti disposed of 50% of the equity of Ceram for a consideration of \$90 million. Ceram's identifiable net assets were \$160 million and the NCI was \$35 million at the date of disposal. The remaining equity interest of Ceram held by Ashanti was fair valued at \$45 million. After the disposal, Ashanti can still exert significant influence. Goodwill had been impairment tested and no impairment had occurred. Ceram's total profit for the year ended 30 April 20X9 was \$14 million and can be assumed to have accrued evenly.

Additional transactions

Ashanti sold inventory to both Bochem and Ceram in October 20X8. The sale price of the inventory was \$10 million and \$5 million respectively. Ashanti sells goods at a gross profit margin of 20% to group companies. At the year-end, half of the inventory sold to Bochem remained unsold but the entire inventory sold to Ceram had been sold to third parties.

At the year end, Ashanti sold goods on credit to Spice, an unrelated company, and recognised revenue of \$5 million. Before the date of the sale, the customer had made an announcement that it would be restructuring its debts. At the date of the sale, it was deemed improbable that Ashanti would recover the amounts outstanding.

Required:

- (a) (i) Explain, with suitable calculations, how Ashanti should deal with the sale of the equity interests in Bochem in the consolidated financial statements. (6 marks)
- (ii) Explain, with suitable calculations, how Ashanti should deal with the sale of the equity interests in Ceram and its remaining investment in Ceram in the consolidated statement of profit or loss. (8 marks)
- (iii) Taking into account all of the information presented, calculate the 'revenue' and 'cost of sales' figures that would appear in the consolidated statement of profit or loss. Your answer should include an explanation of the correct treatment of Ashanti's sale to Spice. (9 marks)

(b) Night

The directors of Ashanti are considering acquiring 49.9% of the equity shares of Night. The next biggest shareholders will be Night's two original founders, who will hold 21% and 8% of the equity shares respectively. The original founders are not related. The remaining 21.1% of the shares will be held by 11 shareholders, who are acquaintances of the original founders but whom have a remote relationship to one another. There has not been complete owner representation at the last three annual general meetings of Night. Ashanti will have the ability to appoint four of the six members of Night's Board of Directors ('the Board'). The Board of Night have overall responsibility for decisions that affect the entity's operations.

Required:

Discuss whether the proposed share purchase will lead to Ashanti obtaining control over Night. (7 marks)

(Total: 30 marks)

13 TRAILER  *Walk in the footsteps of a top tutor*
Background and financial statement extracts

Trailer, a public limited company, operates in the manufacturing sector. Trailer purchased an investment in part during the reporting period. Extracts from the draft statements of financial position at 31 May 20X3 are as follows:

	Trailer \$m	Park \$m
Equity:		
Share capital	1,750	1,210
Retained earnings	1,240	930
Other components of equity	125	80
	<hr/>	<hr/>
Total equity	3,115	2,220
	<hr/>	<hr/>

The following information is relevant to the preparation of the group financial statements:

Loan to charity

Trailer has made a loan of \$50 million to a charitable organisation for the building of new sporting facilities. The loan was made on 1 June 20X2 and is repayable on maturity in three years' time. The interest rate on the loan is 3%, but Trailer assesses that an unsubsidised rate for such a loan would have been 6%. The first interest payment was made on 31 May 20X3. Trailer initially recorded a financial asset at \$50 million and reduced this by the interest received during the period. The loss allowance has been correctly dealt with.

Restructuring plans

Trailer has announced two major restructuring plans. The first plan is to reduce its capacity by the closure of some of its smaller factories, which have already been identified. This will lead to the redundancy of 500 employees, who have all individually been selected and communicated with. The costs of this plan are \$14 million in redundancy costs and \$4 million in retraining costs. The second plan is to re-organise the finance and information technology department over a one-year period but it does not commence for two years. The plan results in 20% of finance staff losing their jobs during the restructuring. The costs of this plan are \$10 million in redundancy costs and \$6 million in retraining costs. No entries have been made in the financial statements for the above plans.

Acquisition of Park

On 1 June 20X2, Trailer acquired 60% of the equity interests of Park, a public limited company. The purchase consideration comprised cash of \$1,250 million.

On 1 June 20X2, the fair value of the identifiable net assets acquired was \$1,950 million and retained earnings of Park were \$650 million and other components of equity were \$55 million. The excess in fair value is due to plant and machinery with a remaining useful life of 7 years as at the acquisition date. It is the group's policy to measure the non-controlling interest (NCI) at acquisition at its proportionate share of the fair value of the subsidiary's net assets.

The goodwill of Park was impairment tested at 31 May 20X3. The recoverable amount of the net assets of Park was \$2,083 million. There was no impairment of the net assets of Park before this date.

Required:

- (a)
 - (i) Discuss, with suitable workings, how the loan to the charitable organisation should be dealt with in the consolidated financial statements for the year ended 31 May 20X3. (6 marks)
 - (ii) Discuss how the restructuring plans should be dealt with in the consolidated financial statements for the year ended 31 May 20X3. (5 marks)
 - (iii) Prepare the equity section of the consolidated statement of financial position as at 31 May 20X3. (12 marks)
- (b) **NCI at fair value**

It is the Trailer group's policy to measure the NCI at acquisition at its proportionate share of the fair value of the subsidiary's net assets. The directors of Trailer have used this policy for several years and do not know the implications, if any, of accounting for the NCI at fair value. The fair value of the NCI of Park at 1 June 20X2 was \$800 million.

Required:

Explain to the directors, with suitable calculations, the impact on the financial statements if goodwill arising on the acquisition of Park had been calculated using the fair value of the NCI. (7 marks)

(Total: 30 marks)

14 WESTON  *Walk in the footsteps of a top tutor*
Background

Weston has appointed a new financial controller. Weston calculates 'cash generated from operations' using the indirect method. The following information relates to the financial statements of the Weston Group:

Extracts from Weston Group: Statement of financial position as at 31 January

	20X6 \$m	20X5 \$m
Non-current assets		
Property, plant and equipment	389	413
Goodwill	4	19
Investment in associate	102	–
Current assets		
Inventories	108	165
Trade and other receivables	106	104
Cash and cash equivalents	39	43
Non-current liabilities		
Retirement benefit liability	60	72
Net deferred tax liability	14	15
Current liabilities		
Trade and other payables	36	41
Current tax payable	47	92

Extracts from statement of profit or loss and other comprehensive income for the year ended 31 January 20X6

Continuing operations	\$m
Profit from operations	167
Share of profit of associate	16
	<hr/>
Profit before tax	183
Income tax expense	(40)
	<hr/>
Profit for the year from continuing operations	143
Discontinued operations	
Loss for the year from discontinued operations (see note 2)	(25)
	<hr/>
Total profit for the year	118
	<hr/>

Other comprehensive income for the year (after tax) which will not be reclassified to profit or loss in future years	
Remeasurement gains on defined benefit plan	3
	<hr/>
Total comprehensive income for the year	121
	<hr/>

Additional information for preparation of statement of cash flows

- 1 On 31 July 20X5, Weston disposed of its entire 80% equity holding in Northern for cash. The shares had been acquired on 31 July 20X1 for a consideration of \$132 million when the fair value of the net assets was \$124 million. This included a fair value uplift of \$16 million in relation to plant with a remaining useful life of eight years. Deferred tax at 25% on the fair value adjustment was also correctly provided for in the group accounts and is included within the fair value of net assets. The fair value of the non-controlling interest at acquisition was \$28 million. Goodwill, calculated under the full fair value method, was tested annually for impairment.

At 31 January 20X5, goodwill relating to Northern had been impaired by 75%. A goodwill impairment charge has been included within administration expenses for the current year but does not relate to Northern.

The carrying amounts in the individual accounts of Northern at disposal are listed below. The fair value adjustment and subsequent deferred tax were not incorporated into the individual accounts of Northern.

	\$m
Property, plant and equipment	80
Inventories	38
Trade receivables	23
Trade and other payables	(10)
Deferred tax liability	(6)
Bank overdraft	(2)

- 2 The loss for the period from discontinued operations in the consolidated statement of profit or loss and other comprehensive income relates to Northern and can be analysed as follows:

	\$m
Profit before tax	6
Income tax expense	(2)
Loss on disposal	(29)
	<hr/>
	(25)
	<hr/>

- 3 Weston purchased a 40% interest in an associate for cash on 1 February 20X5. The associate paid a dividend of \$10 million in the year ended 31 January 20X6.

- 4 The retirement benefit liability relates to Weston as other companies in the group operate defined contribution schemes. The latest actuarial valuation is as follows:

	\$m
Net obligation at 1 February 20X5	72
Service cost component	11
Contributions to scheme	(19)
Remeasurement gains	(4)
	<hr/>
Net obligation at 31 January 20X6	60
	<hr/>

The benefits paid in the period by the trustees of the scheme were \$7 million. Weston operates in a country which only allows tax relief when contributions are paid into the scheme. The tax base was therefore zero at 31 January 20X5 and 31 January 20X6. The tax rate paid by Weston is 25%. The service cost component is included within administrative expenses.

- 5 There were no disposals of property, plant and equipment during the year except on the sale of Northern. Depreciation for the year was \$20 million and is included within cost of sales.

Required:

- (a) (i) In accordance with IAS 7 *Statement of Cash Flows*, prepare:
- Cash flows from operating activities (using the indirect method)
 - Cash flows from investing activities. (18 marks)
- (ii) Using your answer to part (a) (i), explain how to calculate cash generated from operations using the indirect method. (6 marks)

The Finance Director is considering the acquisition of a 30% investment in Abuelo Co. The acquisition is proposed to occur on 31 July 20X6. Abuelo Co has a functional currency of Dinars. The Financial Controller is uncertain of the accounting treatment of the proposed investment within the Weston Group accounts. The proposed consideration consists of 6m dinars in cash and 1million shares in Weston. The current share price of Weston is \$1.50 per share. It is anticipated that, by the acquisition date, the shares will have grown in value to \$2.00. Weston will exert significant influence on Abuelo Co under the terms of the deal. Abuelo's forecasted information for the year ended 31 January 20X7 shows a profit after tax of 40m dinars.

Exchange rates	dinars: \$1
1 Feb 20X6	5.0
31 July 20X6	6.0
31 January 20X7	7.0
Average exchange rate for year ended 31 January 20X7	5.8

- (b) Explain to the Financial Controller, using illustrative calculations when needed, the accounting treatment of the proposed investment in Abuelo Co within the Weston Group statement of financial position and statement of profit or loss and other comprehensive income for the year ended 31 January 20X7. For any calculations, assume that the forecasted figures are accurate representations. (6 marks)

(Total: 30 marks)

15 JOEY *Walk in the footsteps of a top tutor*

Joey, a public limited company, operates in the media sector. Joey has investments in a number of companies. The draft consolidated statement of financial position at 30 November 20X4 is as follows:

	\$m
Assets:	
Non-current assets	
Property, plant and equipment	6,709
Goodwill	40
Investment in associate (Margy)	700
	<hr/>
	7,449
Current assets	2,011
	<hr/>
Total assets	9,460
	<hr/>
Equity and liabilities:	
Equity attributable to owners of parent	
Share capital	850
Retained earnings	4,086
Other components of equity	258
	<hr/>
	5,194
	<hr/>
Non-controlling interest	908
	<hr/>
Non-current liabilities	2,770
Current liabilities	588
	<hr/>
Total liabilities	3,358
	<hr/>
Total equity and liabilities	9,460
	<hr/>

The following information is required to correct the draft consolidated financial statements:

Acquisition of Hulty

On 1 December 20X3, Joey acquired 80% of Hulty's 600 million \$1 equity shares in exchange for cash of \$750 million. The carrying amount of Hulty's net assets at the acquisition date was \$960 million. Joey determined that the fair value of the 20% non-controlling interest in Hulty at that date was \$250 million. It is group policy to measure the non-controlling interest at fair value. Joey recorded a goodwill asset arising on the acquisition of Hulty of \$40 million (\$750m + \$250m – \$960m).

However, shortly after the acquisition date, the accountant of Joey realised the following:

- Deferred cash consideration of \$50 million arising on the acquisition of Hulty had not been recorded by Joey. This payment is due on 30 November 20X5. An appropriate discount rate is 10%.
- The fair value of Hulty's identifiable net assets had been calculated to be \$980 million as at 1 December 20X3. The excess in the fair value of the net assets over their carrying amounts was due to an unrecognised franchise right with a remaining useful life of four years at 1 December 20X3. No entries have been recorded in respect of this franchise right.

Acquisition of Margy

On 1 December 20X1, Joey acquired 30% of the ordinary shares of Margy for a cash consideration of \$600 million. Joey treated Margy as an associate and has equity accounted for Margy up to 1 December 20X3. Joey's investment in Margy as at 1 December 20X3 is still included in the draft consolidated statement of financial position. At 1 December 20X3, the fair value of the 30% equity interest in Margy held by Joey was \$705 million.

On 1 December 20X3, Joey acquired a further 40% of the ordinary shares of Margy for a cash consideration of \$975 million and gained control of the company. At 1 December 20X3, the fair value of Margy's identifiable net assets was \$2,250 million. The fair value of the non-controlling interest was assessed as \$620 million. A gain on bargain purchase of \$655 million ($\$975\text{m} + \$620\text{m} - \$2,250\text{m}$) has been recorded in profit or loss.

Additionally, buildings with a carrying amount of \$200 million had been included in the fair valuation of Margy at 1 December 20X3. The buildings have a remaining useful life of 20 years at 1 December 20X3. However, Joey had commissioned an independent valuation of the buildings of Margy which was not complete at 1 December 20X3 and therefore not considered in the fair value of the identifiable net assets at the acquisition date. The valuations were received on 1 April 20X4 and resulted in a decrease of \$40 million in the fair value of property, plant and equipment at the date of acquisition. This fair value decrease, which does not affect the fair value of the non-controlling interest at acquisition, has not been entered into the financial statements of Margy or the draft consolidated statements. Buildings are depreciated on the straight-line basis.

Agreement with CP

Joey is looking to expand into publishing and entered into an arrangement with Content Publishing (CP), a public limited company, on 1 December 20X3. CP will provide content for a range of books and online publications.

CP is entitled to a royalty calculated as 10% of sales and 30% of gross profit of the publications. Joey has sole responsibility for all printing, binding, and platform maintenance of the online website. The agreement states that key strategic sales and marketing decisions must be agreed jointly. Joey selects the content to be covered in the publications but CP has the right of veto over this content. However on 1 June 20X4, Joey and CP decided to set up a legal entity, JCP, with equal shares and voting rights. CP continues to contribute content into JCP but does not receive royalties. Joey continues the printing, binding and platform maintenance. The sales and cost of sales in the period were \$5 million and \$2 million respectively. The whole of the sale proceeds and the costs of sales were recorded in Joey's financial statements with no accounting entries being made for JCP or amounts due to CP. Joey currently funds the operations. Assume that the sales and costs accrue evenly throughout the year and that all of the transactions relating to JCP have been in cash.

Shares

Joey's share capital is comprised of 'A' class shares. These shares have been correctly classified as equity. Joey is considering issuing the following instruments:

- 'B' class shares that are not mandatorily redeemable but contain a call option allowing Joey to repurchase them. Dividends would be payable on the B shares if, and only if, dividends are paid on the A ordinary shares.
- Share options which will give the counterparty rights to buy a fixed number of ordinary shares for a fixed amount of \$10 million.

The directors of Joey require advice as to whether these financial instruments should be classified as debt or equity in accordance with IAS 32 *Financial Instruments: Presentation*.

Required:

- Explain, with suitable workings, how to correct the errors that have arisen when accounting for the acquisition of Hulty. Show the adjusting entries required to correct the consolidated statement of financial position. (9 marks)
- Explain, with suitable workings, how to correct the errors that have arisen when accounting for the acquisition of Margy. Show the adjusting entries required to correct the consolidated statement of financial position. (9 marks)
- Discuss, with suitable workings, how the agreement with CP should have been accounted for in the consolidated financial statements. (8 marks)
- In accordance with IAS 32 *Financial Instruments: Presentation*, discuss whether the 'B' class shares and the share options should be classified as financial liabilities or equity. (4 marks)

(Total: 30 marks)

16

PARSLEY



Walk in the footsteps of a top tutor



Answer debrief

Background and draft financial statements

Parsley, a public limited company, has investments in Sage and Saffron. All three companies prepare their financial statements in accordance with International Financial Reporting Standards. The presentation currency of the group is the dollar (\$). Saffron's functional currency is the Franc (FR). The draft statements of profit or loss for the year ended 30 April 20X4 are presented below:

	Parsley	Sage	Saffron
	\$m	\$m	FRm
Revenue	143	68	210
Cost of sales	(61)	(42)	(126)
Gross profit	82	26	84
Distribution costs	(10)	(6)	(14)
Administrative expenses	(23)	(10)	(29)
Operating profit	49	10	41
Investment income	1	2	–
Finance costs	(2)	(4)	(3)
Profit before taxation	48	8	38
Taxation	(11)	(2)	(8)
Profit for the period	37	6	30

The following information is relevant to the preparation of the consolidated financial statements:

Sale of shares in Sage

Parsley acquired 70% of Sage's one million \$1 ordinary shares for \$6 million many years ago. At the acquisition date, the carrying value of Sage's net assets was \$5 million, and this was deemed to be the same as their fair value. The non-controlling interest was measured using the proportion of net assets method. Goodwill arising on the acquisition of Sage has never been impaired. On 31 October 20X3, Parsley sold 300,000 of its shares in Sage for \$6.5 million. The fair value of the interest retained was \$9.5 million. The retained earnings of Sage were \$9 million as at 30 April 20X3. The only entry posted in Parsley's individual financial statements is to record the cash received and to credit these proceeds to a suspense account.

Acquisition of Saffron

On 1 May 20X3, Parsley purchased 60% of Saffron's one million FR1 ordinary shares for FR71 million. The non-controlling interest at acquisition was valued at FR29 million using the fair value method. At 1 May 20X3, the carrying value of Saffron's net assets was FR60 million but the fair value was FR70 million. The excess in fair value was due to an unrecognised brand with a remaining useful economic life of five years at the acquisition date.

At 30 April 20X4, it was determined that goodwill arising on the acquisition of Saffron was impaired by FR4 million.

The following exchange rates are relevant:

	FR: \$1
1 May 20X3	5.0
30 April 20X4	4.0
Average for year ended 30 April 20X4	4.6

Lease

On 1 May 20X2, Parsley signed a lease to use an item of machinery. The useful economic life of the machine and the lease term were both five years. Lease payments are due annually in advance. The lease payment for the first year was \$1.2 million. Parsley's rate of borrowing is 10%. The present value of the lease payments, excluding the payment made on 1 May 20X2, was \$3.8 million.

Lease payments increase annually by the rate of inflation over the previous 12 months. On 1 May 20X3, inflation for the prior 12 months was 8%.

The lease was correctly accounted for in accordance with IFRS 16 *Leases* in the year ended 30 April 20X3. The only entry made in the current year is to record the cash payment made to the lessor within cost of sales.

Required:

- (a) (i) Discuss, with calculations, how Parsley should account for Sage in the consolidated statement of profit or loss and other comprehensive income for the year ended 30 April 20X4. (8 marks)
- (ii) Discuss, with calculations, how Parsley should account for Saffron in the consolidated statement of profit or loss and other comprehensive income for the year ended 30 April 20X4. (8 marks)
- (iii) Explain how the lease agreement should be accounted for in the consolidated financial statements for the year ended 30 April 20X4. Show the adjusting entries required. (8 marks)

Related parties

Related party relationships are a particularly key concern when preparing financial statements for group entities. The objective of IAS 24 *Related Party Disclosures* is to ensure that financial statements contain the necessary disclosures to make users aware of the possibility that financial statements may have been affected by the existence of related parties.

Required:

- (b) Describe the main circumstances that give rise to related parties and explain why the disclosure of related party relationships and transactions is important. (6 marks)

(Total: 30 marks)



Calculate your allowed time, allocate the time to the separate parts.....

17 MARCHANT

*Walk in the footsteps of a top tutor***Tutorial note**

This question requires the preparation of a consolidated statement of profit or loss and other comprehensive income. The examining team have said that the preparation of full consolidated financial statements is unlikely to appear in the Strategic Business Reporting exam. However this question still provides important revision of a range of consolidation issues.

The following draft financial statements relate to Marchant, a public limited company, and companies it has investments in.

Marchant Group: Draft statements of profit or loss and other comprehensive income for the year ended 30 April 20X4.

	Marchant	Nathan	Option
	\$m	\$m	\$m
Revenue	400	115	70
Cost of sales	(312)	(65)	(36)
Gross profit	88	50	34
Other income	21	7	2
Administrative costs	(15)	(9)	(12)
Other expenses	(35)	(19)	(8)
Operating profit	59	29	16
Finance costs	(5)	(6)	(4)
Finance income	6	5	8
Profit before tax	60	28	20
Income tax expense	(19)	(9)	(5)
Profit for the year	41	19	15
Other comprehensive income – revaluation gains	10	2	–
Total comprehensive income for year	51	21	15

The following information is relevant to the preparation of the group statement of profit or loss and other comprehensive income:

- On 1 May 20X2, Marchant acquired 60% of the equity interests of Nathan, a public limited company. The purchase consideration comprised cash of \$80 million and the fair value of the identifiable net assets acquired was \$110 million at that date. The fair value of the non-controlling interest (NCI) in Nathan was \$45 million on 1 May 20X2. Marchant wishes to use the 'full goodwill' method for all acquisitions. The share capital and retained earnings of Nathan were \$25 million and \$65 million respectively and other components of equity were \$6 million at the date of acquisition. The excess of the fair value of the identifiable net assets at acquisition is due to non-depreciable land.

Goodwill has been impairment tested annually and as at 30 April 20X3 had reduced in value by 20%. However at 30 April 20X4, the impairment of goodwill had reversed and goodwill was valued at \$2 million above its original value. This upward change in value has already been included in above draft financial statements of Marchant prior to the preparation of the group accounts.

- 2 Marchant disposed of an 8% equity interest in Nathan on 30 April 20X4 for a cash consideration of \$18 million and had accounted for the gain or loss in other income. The carrying amount of the net assets of Nathan at 30 April 20X4 was \$120 million before any adjustments on consolidation. Marchant accounts for investments in subsidiaries using IFRS 9 *Financial Instruments* and has made an election to show gains and losses in other comprehensive income. The carrying amount of the investment in Nathan was \$90 million at 30 April 20X3 and \$95 million at 30 April 20X4 before the disposal of the equity interest.
- 3 Marchant acquired 60% of the equity interests of Option, a public limited company, on 30 April 20X2. The purchase consideration was cash of \$70 million. Option's identifiable net assets were fair valued at \$86 million and the NCI had a fair value of \$28 million at that date. On 1 November 20X3, Marchant disposed of a 40% equity interest in Option for a consideration of \$50 million. Option's identifiable net assets were \$90 million and the value of the NCI was \$34 million at the date of disposal. The remaining equity interest was fair valued at \$40 million. After the disposal, Marchant exerts significant influence. Any increase in net assets since acquisition has been reported in profit or loss and the carrying amount of the investment in Option had not changed since acquisition. Goodwill had been impairment tested and no impairment was required. No entries had been made in the financial statements of Marchant for this transaction other than for cash received.
- 4 Marchant sold inventory to Nathan for its fair value of \$12 million. Marchant made a loss on the transaction of \$2 million. Nathan still holds \$8 million of this inventory at the year end.
- 5 Ignore the taxation effects of the above adjustments. Any expense adjustments should be amended in other expenses.

Required:

- (a) (i) **Prepare a consolidated statement of profit or loss and other comprehensive income for the year ended 30 April 20X4 for the Marchant Group.**

Note: Do not adjust your answer for the information presented in part (b)

(18 marks)

- (ii) **Explain, with suitable calculations, how the sale of the 8% interest in Nathan should be dealt with in the group statement of financial position at 30 April 20X4.**

(5 marks)

- (b) Marchant held a portfolio of trade receivables with a carrying amount of \$4 million at 30 April 20X4. At that date, the entity entered into a factoring agreement with a bank, whereby it transferred the receivables in exchange for \$3.6 million in cash. Marchant has agreed to reimburse the factor for any shortfall between the amount collected and \$3.6 million. Once the receivables have been collected, any amounts above \$3.6 million, less interest on this amount, will be repaid to Marchant. Marchant has derecognised the receivables and charged \$0.4 million as a loss to profit or loss.

Required:

Outline the rules in IFRS 9 *Financial Instruments* relating to the derecognition of a financial asset and discuss how these rules affect the treatment of the portfolio of trade receivables in Marchant's financial statements. (7 marks)

(Total: 30 marks)

18 ANGEL  *Walk in the footsteps of a top tutor*



Tutorial note

This question requires the preparation of a consolidated statement of cash flows. The examining team have said that the preparation of full consolidated financial statements is unlikely to appear in the Strategic Business Reporting exam. However this question still provides important revision of a range of consolidation issues.

The following draft group financial statements relate to Angel, a public limited company:

Angel Group: Statement of financial position as at 30 November 20X3

	30 November 20X3 \$m	30 November 20X2 \$m
Assets		
Non-current assets		
Property, plant and equipment	475	465
Goodwill	105	120
Other intangible assets	150	240
Investment in associate	80	
Financial assets	215	180
	<hr/>	<hr/>
	1,025	1,005
	<hr/>	<hr/>
Current assets		
Inventories	155	190
Trade receivables	125	180
Cash and cash equivalents	465	355
	<hr/>	<hr/>
	745	725
	<hr/>	<hr/>
Total assets	1,770	1,730
	<hr/>	<hr/>

Equity and liabilities

Share capital	850	625
Retained earnings	456	359
Other components of equity	29	20
	<u>1,335</u>	<u>1,004</u>
Non-controlling interest	90	65
Total equity	<u>1,425</u>	<u>1,069</u>
Non-current liabilities		
Long-term borrowings	26	57
Deferred tax	35	31
Retirement benefit liability	80	74
Total non-current liabilities	<u>141</u>	<u>162</u>
Current liabilities		
Trade payables	155	361
Current tax payable	49	138
Total current liabilities	<u>204</u>	<u>499</u>
Total liabilities	<u>345</u>	<u>661</u>
Total equity and liabilities	<u>1,770</u>	<u>1,730</u>

Angel Group: Statement of profit or loss and other comprehensive income for the year ended 30 November 20X3

	\$m
Revenue	1,238
Cost of sales	(986)
Gross profit	<u>252</u>
Other income	30
Administrative expenses	(45)
Other expenses	(50)
Operating profit	<u>187</u>
Finance costs	(11)
Share of profit of associate	12
Profit before tax	<u>188</u>
Income tax expense	(46)
Profit for the year	<u>142</u>
Profit attributable to:	
Owners of parent	111
Non-controlling interest	31
	<u>142</u>

	\$m
Other comprehensive income:	
Items that will not be reclassified to profit or loss	
Revaluation of property, plant and equipment	8
Actuarial losses on defined benefit plan	(4)
Tax relating to items not reclassified	(2)
	<hr/>
Total items that will not be reclassified to profit or loss	2
	<hr/>
Items that may be reclassified to profit or loss	
Financial assets	4
Tax relating to items that may be reclassified	(1)
	<hr/>
Total items that may be reclassified to profit or loss	3
	<hr/>
Other comprehensive income (net of tax) for the year	5
	<hr/>
Total comprehensive income for year	147
	<hr/>
Total comprehensive income attributable to:	
Owners of the parent	116
Non-controlling interest	31
	<hr/>
	147
	<hr/>

Angel Group: Extracts from statement of changes in equity for the year ended 30 November 20X3

	Share capital	Retained earnings	Other components of equity – financial assets reserve	Other components of equity – revaluation reserve	Non-controlling interest
	\$m	\$m	\$m	\$m	\$m
Balance 1 December 20X2	625	359	15	5	65
Share capital issued	225				
Dividends for year		(10)			(6)
Total comprehensive income for the year		107	3	6	31
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>
Balance 30 November 20X3	850	456	18	11	90
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>

The following information relates to the financial statements of the Angel Group:

- (i) On 1 December 20X2, Angel acquired all of the share capital of Sweety for \$30 million. The carrying amounts of the identifiable net assets in Sweety's individual financial statements and the fair values are set out below, together with their tax base. Goodwill arising on acquisition is not deductible for tax purposes. There were no other acquisitions in the period. The tax rate is 30%.

The fair values in the table below have been reflected in the year-end balances of the Angel Group.

	Carrying amounts \$ million	Tax base \$ million	Fair values \$million (excluding deferred taxation)
Property, plant and equipment	12	10	14
Inventories	5	4	6
Trade receivables	3	3	3
Cash and cash equivalents	2	2	2
	<hr/>	<hr/>	<hr/>
Total assets	22	19	25
Trade payables	(4)	(4)	(4)
Retirement benefit obligations	(1)		(1)
Deferred tax liability	(0.6)		
	<hr/>	<hr/>	<hr/>
Net assets at acquisition	16.4	15	20
	<hr/>	<hr/>	<hr/>

- (ii) The retirement benefit is classified as a non-current liability in the statement of financial position and comprises the following:

	\$m
Net obligation at 1 December 20X2	74
Net interest cost	3
Current service cost	8
Contributions to scheme	(9)
Remeasurements – actuarial losses	4
	<hr/>
Net obligation at 30 November 20X3	80
	<hr/>

The benefits paid in the period by the trustees of the scheme were \$6 million. Angel had included the obligation assumed on the purchase of Sweety in current service cost above, although the charge to administrative expenses was correct in the statement of profit and loss and other comprehensive income. There were no tax implications regarding the retirement benefit obligation. Defined benefit costs are included in administrative expenses.

- (iii) Property, plant and equipment (PPE) with a carrying amount of \$49 million was disposed of for cash proceeds of \$63 million. The gain on disposal is included in administrative expenses. Depreciation charged to profit or loss in the year was \$29 million.
- (iv) Angel purchased a 30% interest in an associate for cash on 1 December 20X2. The net assets of the associate at the date of acquisition were \$280 million. The associate made a profit after tax of \$40 million and paid a dividend of \$10 million out of these profits in the year ended 30 November 20X3. Angel does not hold investments in any other associate entities.

- (v) An impairment test carried out at 30 November 20X3 showed that goodwill and other intangible assets were impaired. The impairment of goodwill relates to 100% owned subsidiaries.
- (vi) The following schedule relates to the financial assets owned by Angel:

	\$m
Balance 1 December 20X2	180
Less carrying amount of financial assets disposed	(26)
Add purchases of financial assets	57
Add gain on revaluation of financial assets	4
	<hr/>
Balance at 30 November 20X3	215
	<hr/>

The sale proceeds of the financial assets were \$40 million. Profit on the sale of the financial assets is included in 'other income' in the financial statements.

- (vii) The finance costs were all paid in cash in the period.

Required:

- (a) Prepare a consolidated statement of cash flows using the indirect method for the Angel Group plc for the year ended 30 November 20X3 in accordance with the requirements of IAS 7 *Statement of Cash Flows*.

Note: The notes to the statement of cash flows are not required. (25 marks)

- (b) The directors of Angel have deposited funds with a bank in two accounts as follows:
- (i) \$3 million into a 12-month term account, earning 3.5% interest. The cash can be withdrawn by giving 14 days' notice but Angel will incur a penalty, being the loss of all interest earned.
 - (ii) \$7 million into a 12-month term account earning 3% interest. The cash can be withdrawn by giving 21 days' notice. Interest will be paid for the period of the deposit but if money is withdrawn, the interest will be at the rate of 2%, which is equivalent to the bank's stated rate for short-term deposits.

Angel is confident that it will not need to withdraw the cash from the higher-rate deposit within the term, but wants to keep easy access to the remaining \$7 million to cover any working capital shortfalls which might arise.

Required:

Advise Angel on whether each of the funds meets the definition of a 'cash equivalent'. (5 marks)

(Total: 30 marks)

19 TRAVELER  *Walk in the footsteps of a top tutor***Tutorial note**

This question requires the preparation of a consolidated statement of financial position. The examining team have said that the preparation of full consolidated financial statements is unlikely to appear in the Strategic Business Reporting exam. However this question still provides important revision of a range of consolidation issues.

Traveler, a public limited company, operates in the manufacturing sector. The draft statements of financial position are as follows at 30 November 20X1:

	Traveler \$m	Data \$m	Captive \$m
Assets:			
Non-current assets			
Property, plant and equipment	439	810	620
Investments in subsidiaries			
Data	820		
Captive	541		
Financial assets	108	10	20
	<hr/>	<hr/>	<hr/>
	1,908	820	640
Current assets	1,067	781	350
	<hr/>	<hr/>	<hr/>
Total assets	2,975	1,601	990
	<hr/>	<hr/>	<hr/>
Equity and liabilities:			
Share capital	1,120	600	390
Retained earnings	1,066	442	169
Other components of equity	60	37	45
	<hr/>	<hr/>	<hr/>
Total equity	2,246	1,079	604
	<hr/>	<hr/>	<hr/>
Non-current liabilities	455	323	73
Current liabilities	274	199	313
	<hr/>	<hr/>	<hr/>
Total equity and liabilities	2,975	1,601	990
	<hr/>	<hr/>	<hr/>

The following information is relevant to the preparation of the group financial statements:

- On 1 December 20X0, Traveler acquired 60% of the equity interests of Data, a public limited company. The purchase consideration comprised cash of \$600 million. At acquisition, the fair value of the non-controlling interest in Data was \$395 million. Traveler wishes to use the 'full goodwill' method. On 1 December 20X0, the fair value of the identifiable net assets acquired was \$935 million and retained earnings of Data were \$299 million and other components of equity were \$26 million. The excess in fair value is due to non-depreciable land.

On 30 November 20X1, Traveler acquired a further 20% interest in Data for a cash consideration of \$220 million.

- 2 On 1 December 20X0, Traveler acquired 80% of the equity interests of Captive for a consideration of \$541 million. The consideration comprised cash of \$477 million and the transfer of non-depreciable land with a fair value of \$64 million. The carrying amount of the land at the acquisition date was \$56 million. At the year end, this asset was still included in the non-current assets of Traveler and the sale proceeds had been credited to profit or loss.

At the date of acquisition, the identifiable net assets of Captive had a fair value of \$526 million, retained earnings were \$90 million and other components of equity were \$24 million. The excess in fair value is due to non-depreciable land. This acquisition was accounted for using the partial goodwill method in accordance with IFRS 3 *Business Combinations*.

- 3 Goodwill was impairment tested after the additional acquisition in Data on 30 November 20X1. The recoverable amount of the net assets and goodwill of Data was \$1,099 million and that of Captive was \$700 million.

Required:

- (a) **Prepare a consolidated statement of financial position for the Traveler Group for the year ended 30 November 20X1.** (23 marks)
- (b) At the start of the year to 30 November 20X2, Traveler acquired a major subsidiary. The inventory acquired in this business combination was valued at its fair value at the acquisition date in accordance with IFRS 3 *Business Combinations*. The inventory increased in value as a result of the fair value exercise. A significant part of the acquired inventory was sold shortly after the acquisition.

In the consolidated statement of profit or loss and other comprehensive income, the directors of Traveler intend to split the cost of inventories acquired in the business combination and sold by the acquirer after the business combination over two different lines: cost of sales, and a 'non-recurring item' within operating income. The part presented under cost of sales will correspond to the inventory's carrying amount in the subsidiary's financial statements. The part to be presented as a 'non-recurring item' corresponds to the fair value increase recognised on the business combination. The 'non-recurring item' amounted to 25% of Traveler's earnings before interest and tax (EBIT).

Traveler intends to disclose this accounting policy in the notes to the financial statements and to explain that showing the full fair value of the inventory within cost of sales would result in a fall in the gross margin. Traveler argues that isolating this part of the margin in the 'non-recurring items', whose nature is transparently presented in the notes, will enable users to evaluate changes in gross margin.

Required:

Discuss whether Traveler's proposal is in accordance with IFRS® Standards.

(7 marks)

(Total: 30 marks)

20

ROSE

*Walk in the footsteps of a top tutor***Tutorial note**

This question requires the preparation of a consolidated statement of financial position where one of the subsidiaries presents its financial statements in a different currency to the group. The examining team have said that the preparation of full consolidated financial statements is unlikely to appear in the Strategic Business Reporting exam. However this question still provides important revision of a range of consolidation issues.

Rose, a public limited company, operates in the mining sector. The draft statements of financial position are as follows, at 30 April 20X1:

	Rose	Petal	Stem
	\$m	\$m	Dinars m
Assets			
Non-current assets			
Property, plant and equipment	385	117	430
Investments in subsidiaries			
Petal	113		
Stem	46		
	544	117	430
Current assets	118	100	330
Total assets	662	217	760
Equity and liabilities			
Share capital	158	38	200
Retained earnings	256	56	300
Other components of equity	7	4	–
Total equity	421	98	500
Non-current liabilities	56	42	160
Current liabilities	185	77	100
Total liabilities	241	119	260
Total equity and liabilities	662	217	760

The following information is relevant to the preparation of the group financial statements:

- 1 On 1 May 20X0, Rose acquired 70% of the equity interests of Petal, a public limited company. The purchase consideration comprised cash of \$94 million. The fair value of the identifiable net assets recognised by Petal was \$120 million excluding the patent below. The identifiable net assets of Petal at 1 May 20X0 included a patent which had a fair value of \$4 million. This had not been recognised in the financial statements of Petal. The patent had a remaining term of four years to run at that date and is not renewable. The retained earnings of Petal were \$49 million and other components of equity were \$3 million at the date of acquisition. The remaining excess of the fair value of the net assets is due to an increase in the value of land.

Rose wishes to use the 'full goodwill' method. The fair value of the non-controlling interest in Petal was \$46 million on 1 May 20X0. There have been no issues of ordinary shares since acquisition and goodwill on acquisition is not impaired.

Rose acquired a further 10% interest from the non-controlling interest in Petal on 30 April 20X1 for a cash consideration of \$19 million.

- 2 Rose acquired 52% of the ordinary shares of Stem on 1 May 20X0 when Stem's retained earnings were 220 million dinars. The fair value of the identifiable net assets of Stem on 1 May 20X0 was 495 million dinars. The excess of the fair value over the net assets of Stem is due to an increase in the value of land. Rose wishes to use the 'full goodwill' method. The fair value of the non-controlling interest in Stem at 1 May 20X0 was 250 million dinars. There have been no issues of ordinary shares and no impairment of goodwill since acquisition.

The following exchange rates are relevant to the preparation of the group financial statements:

	Dinars to \$
1 May 20X0	6
30 April 20X1	5
Average for year to 30 April 20X1	5.8

Required:

- (a) Prepare a consolidated statement of financial position of the Rose Group at 30 April 20X1, in accordance with International Financial Reporting Standards, showing the exchange difference arising on the translation of Stem's net assets. Ignore deferred taxation. (22 marks)
- (b) The directors of Rose are not fully aware of the requirements of IAS 21 *The Effects of Changes in Foreign Exchange Rates* in relation to exchange rate differences. They would like advice on how exchange differences should be recorded on both monetary and non-monetary assets in the financial statements and how these differ from the requirements for the translation of an overseas entity. The directors also wish advice on what would happen to the exchange differences if Rose sold all of its equity shares in Stem.

Required:

Provide a brief memo for the directors of Rose which identifies the correct accounting treatment for the various issues raised. (8 marks)

(Total: 30 marks)

SECTION A QUESTIONS – REPORTING AND ETHICAL IMPLICATIONS

21 AGENCY GROUP (SEP/DEC 2021)



Walk in the footsteps of a top tutor

Background

The Agency Group manufactures products for the medical industry. They have been suffering increased competition and, therefore, have sold a licence to distribute an existing product. They have also developed a new product which they hope will improve their market reputation. They have recently employed an ACCA student accountant. The year end is 31 December 20X7.

Ethical issues and foreign exchange

On 1 October 20X7, the finance director, Ms Malgun, a financial accountant, recruited Mr Raavi as an ACCA student accountant on a temporary employment contract which can be terminated by either party without reason. Mr Raavi has found it difficult to find employment and accepted the risk attached to the employment contract. However, the jurisdiction has laws which protect employees from termination due to discrimination. Mr Raavi has been told by Ms Malgun that there has been a global slowdown in business and that the biggest uncertainty is customer demand. She has therefore impressed upon Mr Raavi that the company profitability targets are based upon achieving 30% higher net profit than their nearest competitors. Ms Malgun is partly remunerated through profit related pay.

Ms Malgun has been under significant pressure from the board of directors to meet performance targets and would normally prepare the year-end financial statements. However, for the current year end, she has delegated this task to Mr Raavi.

Mr Raavi has included in profit or loss the foreign exchange gains arising on the re-translation of a foreign subsidiary which is held for sale. Mr Raavi has emailed Ms Malgun informing her of the accounting treatment. Although Ms Malgun is an expert in IFRS standards, she did not comment on this incorrect accounting treatment of the foreign exchange gains.

After the financial statements had been published, Ms Malgun disciplined Mr Raavi for the incorrect accounting treatment of the foreign exchange gains. However, despite this, she is prepared to make his employment contract permanent.

Sale of licence

On 1 January 20X7, Agency Co granted (sold) Kokila Co a licence with no end date to sell a headache product (Headon) in South America. Agency Co has retained the rights to sell Headon in the rest of the world. The South American market's relative value compared to the rest of the world is 20%. The manufacturing process used to produce Headon is not specialised and several other entities could also manufacture it for Kokila Co. Kokila Co will purchase Headon directly from Agency Co at cost plus 50%. The product has been sold for many years.

On 1 January 20X7, Kokila Co made an up-front payment of \$15 million and will make an additional payment of \$3 million when South American sales exceed \$35 million. Agency Co had correctly capitalised development costs for Headon as an intangible asset at a carrying amount of \$30 million.

Drug development

Agency Co is developing a biosimilar product for the treatment of a particular medical condition. A biosimilar product is one which is highly similar to another which has already been given regulatory approval. The existing approved product's (Xudix) patent is expiring and AgencyCo has applied to the government for regulatory approval of its new product. The submission includes an analysis which compares Xudix to Agency Co's proposed product in order to demonstrate biosimilarity. The government has reviewed the analysis and allowed Agency Co to undertake initial medical trials. Agency Co feels that the trials are going well. The product is used in the treatment of a very specific condition which affects only a small group of people, and Agency Co has decided to develop this product for reputational reasons. A person using the product will only pay a notional amount for the product if it is proven to be effective.

Required:

- (a) (i) Discuss the appropriateness of Mr Raavi's accounting treatment of the foreign exchange gains on the re-translation of the foreign subsidiary which is held for sale. (3 marks)
- (ii) Discuss any ethical issues raised by Ms Malgun's actions regarding her management of Mr Raavi. (6 marks)
- (b) Discuss how the granting (sale) of the licence to Kokila Co should be accounted for by Agency Co on 1 January 20X7. (5 marks)
- (c) Discuss the accounting treatment of the costs incurred to date in developing the biosimilar drug. (4 marks)

Professional marks will be awarded in part (a)(ii) for the quality of the discussion. (2 marks)

(Total: 20 marks)

22 BISMUTH (MAR/JUN 2021)


Walk in the footsteps of a top tutor

Background

Bismuth Co is a mining company. Investors in Bismuth Co receive earnings from mining projects as a return on their investment. The year end is 31 December 20X7.

Impairment testing of mines

At 31 December 20X7, Bismuth Co owns mines which have a carrying amount of \$200 million. The company has committed itself to decommissioning its mines at the end of their useful life (five years or less) and has created a decommissioning provision of \$53 million. However, the directors are unsure how the decommissioning provision will impact on the impairment testing of the mines. At the end of the useful life of a mine, its reusable components will be dismantled and sold.

The following information relates to the decommissioning of the mines at 31 December 20X7:

	\$million
Carrying amount of decommissioning provision	53
Present value of future cash inflows from:	
– sale of reusable components at decommission date (inflows)	20
– sale of mining output from 31 December 20X7 to decommission date (inflows)	203
– operating costs from 31 December 20X7 to decommission date (outflows)	48

Class A and Class B shares

Bismuth Co has issued two classes of shares, class A and class B, in exchange for a cryptocurrency, Bitcoin. Both types of shares permit the holder to vote and give an entitlement to 'rewards'. Bismuth Co has discretion over whether 'rewards' are payable on class A and class B shares. Bitcoin can be readily converted into cash in Bismuth Co's jurisdiction.

Class A shares are redeemable at par in the event of Bismuth Co obtaining a listing on a formal stock exchange which is highly probable. On listing, Bismuth Co has a choice as to the method of redemption either:

- (i) cash to the value of 1 Bitcoin per 1000 class A shares, or
- (ii) shares to the value of 2 Bitcoins per 1000 class A shares.

Note: 1 Bitcoin equates to approximately \$12,000

The share settlement option, option (ii) above, would involve exchanging class A shares for the equivalent number of class B shares. Class B shares have never fluctuated in value.

Bismuth Co is not compelled to redeem the class B shares but these shares do contain an option allowing Bismuth Co to repurchase them. However, if within two years, Bismuth Co fails to exercise its call option on the class B shares, it must pay an additional reward to the holders of class B shares.

Blockchain technology

Bismuth Co plans to implement Blockchain technology to store all of its data relating to its mines, trading and to certify the ethical sourcing of all its raw materials. The chief accountant, Ms Pleasant, is currently developing a blockchain technology that will be filed for patent. Ms Pleasant has only recently taken up the post and has discovered that work done at her previous employer, Gypsam Co, is relevant to the project. If Ms Pleasant discloses this information, it will compromise a patent process at Gypsam Co but will consolidate her position as chief accountant in Bismuth Co. When she left the employment of Gypsam Co, she signed a confidentiality agreement but the clauses were not clear or specific about what information could be shared and with whom.

Ms Pleasant has significant knowledge of Blockchain technology but the finance director, Mr Fricklin has limited knowledge of it or the new business model that Bismuth Co is trying to develop. Mr Fricklin has told her that there is no need to spend a significant amount of time creating a technology to ethically source materials. Ms Pleasant is worried about Mr Fricklin's lack of technical and legal knowledge as she feels that it will affect the development of the technology. In addition, some of the data concerning ethically sourced materials has gone missing and she thinks that Mr Fricklin has erased the data to try and sabotage the project. Mr Fricklin has told the Board of Directors that he has an 'in depth knowledge' of the technology.

Required:

- (a) Discuss, with suitable calculations, whether Bismuth Co should recognise an impairment loss for the mines. (5 marks)
- (b) Discuss whether the class A and B shares should be classified as either equity or liability in accordance with IAS 32 *Financial Instruments: Presentation*. (5 marks)
- (c) Discuss the ethical issues raised by the implementation of the blockchain technology for both the chief accountant and the finance director, including any appropriate actions which should be considered to resolve these issues. (8 marks)

Professional marks will be awarded in part (c) for the quality of the discussion. (2 marks)

(Total: 20 marks)

23 CALIBRA (SEP/DEC 2020) *Walk in the footsteps of a top tutor*

Calibra Co operates in the property sector and has invested in new technology, distributed ledgers/blockchain, to trade and to support property transactions. The financial year end of Calibra Co is 31 December 20X8.

Apartment blocks

Calibra Co builds apartment blocks which normally take two years to complete from the date of signing the contract. The performance obligation is satisfied at a point in time. The title and possession, and therefore control, of the apartment blocks pass to the customer upon completion of construction. The price which is payable on completion of each apartment block is \$9.55 million. Alternatively, customers can pay \$8.5 million cash on the day that the contract is signed. The chief accountant has calculated that this represents an appropriate borrowing rate of 6% for Calibra Co.

Calibra Co immediately recognises \$8.5 million as revenue if customers pay when they sign the contract.

Chief accountant and Bodoni Co

The chief accountant does not hold a permanent employment contract with Calibra Co. He has applied for the position on a permanent basis and is to be interviewed in the near future. Bodoni Co, a customer of Calibra Co, wanted to take advantage of the \$8.5 million reduced price for an apartment block but was having problems with cash flow. The chief accountant therefore allowed Bodoni Co to pay \$8.5 million and to delay payment until one month after the contract was signed. In return, Bodoni Co has agreed to provide a good employment reference. The chief accountant of Calibra Co was afraid that he might lose Bodoni Co as a customer and referee if he did not agree to the delay in payment.

Distributed ledger technology

Calibra Co has recently used distributed ledger technology/blockchain to sell shares in a property to investors. These digitised transactions are only visible to the authorised parties. The chief accountant publicly supports this technology and is to manage the new system. However, he has private concerns over the reliability of the due diligence carried out on the sale of property shares and the potential violation of local regulations. The directors of Calibra Co want to increase the number of transactions on the distributed ledger by offering digital shares in the whole of the entity's property portfolio. Although the chief accountant has very basic knowledge of distributed ledgers, he has assured the directors that he can facilitate this move. The project has been approved by the board despite the chief accountant's private reservations. The chief accountant has only recently qualified as an accountant and wishes to be employed with Calibra Co on a permanent basis.

Required:

- (a) Discuss how Calibra Co should have accounted for the sale of the apartment blocks in accordance with IFRS 15 *Revenue from Contracts with Customers* and IAS 23 *Borrowing Costs*. (5 marks)
- (b) Provide the accounting entries that would be required to record the contractual sale of an apartment block on 1 January 20X8 at the discounted amount over the two-year construction period. (3 marks)
- (c) Discuss the way in which the chief accountant should have acted to ensure that he maintained ethical standards in dealing with the issues described. (10 marks)

Professional marks will be awarded in part (c) for the quality of the ethical discussion. (2 marks)

(Total: 20 marks)

24 BAGSHOT (MAR 2020) *Walk in the footsteps of a top tutor*

Background

Bagshot Co has a controlling interest in a number of entities. Group results have been disappointing in recent years and the directors of Bagshot Co have been discussing various strategies to improve group performance. The current financial year end is 31 December 20X5.

The following personnel are relevant to the scenario:

Mr Shaw: Head accountant of Bagshot Co

Mrs Dawes: Chief executive of Bagshot Co

Mike Starr: Nephew of Mr Shaw

Mrs Shaw: Wife of Mr Shaw

Group restructure

Mr Shaw, an ACCA member, is the head accountant of Bagshot Co. He is not a member of the board of directors. Mrs Dawes, the chief executive of Bagshot Co, is also an ACCA member. During December 20X5, Mrs Dawes revealed plans to Mr Shaw of a potential restructure of the Bagshot group which had been discussed at board meetings. The restructuring plans included a general analysis of expected costs which would be incurred should the restructure take place. These include legal fees, relocation costs for staff and also redundancy costs for a number of employees. One such employee to be made redundant, Mike Starr, is the nephew of Mr Shaw.

Mrs Dawes is insistent that Mr Shaw should include a restructuring provision for all of the expenditure in the financial statements of Bagshot Co for the year ended 31 December 20X5. Mrs Dawes argues that, even if the restructure did not take place exactly as detailed, similar levels of expenditure are likely to be incurred on alternative strategies. It would therefore be prudent to include a restructuring provision for all expenditure. None of the staff other than Mr Shaw have been notified of the plans although Mrs Dawes has informed Mr Shaw that she expects a final decision and public announcement to be made prior to the authorisation of the financial statements.

Mrs Shaw

Mrs Shaw is the wife of Mr Shaw, the head accountant of Bagshot Co. She is not an employee of Bagshot Co and does not know about the proposed restructure. However, Mrs Shaw recently acquired 5% of the equity shares in Bagshot Co. Mr Shaw is considering informing his wife of the proposed restructure so that she can make an informed decision as to whether to divest her shareholding or not. Mr Shaw is concerned that, in the short term at least, the inclusion of any restructuring costs would be harmful to the profitability of Bagshot Co. It is also uncertain as to how the market may react should the restructure take place. It is, however, anticipated that in the long term, shareholder value would be enhanced.

Required:

- (a) (i) Discuss the appropriate accounting treatment of the restructuring costs in the financial statements of Bagshot Co for the year ended 31 December 20X5. (6 marks)
- (ii) Discuss what is meant by good stewardship of a company and whether the restructure and the recognition of a restructuring provision in the financial statements are examples of good stewardship. (4 marks)
- (iii) Discuss briefly whether Mrs Shaw's acquisition of the equity shares in Bagshot Co should be disclosed as a related party transaction. (3 marks)
- (b) Identify and discuss the ethical issues arising from the scenario which Mr Shaw needs to consider and what actions he should take as a consequence. (5 marks)

Professional marks will be awarded in part (b) for the clarity of discussion. (2 marks)

(Total: 20 marks)

25 STENT (SEP/DEC 2019)



Walk in the footsteps of a top tutor



Answer debrief

Stent Co is a consumer electronics company which has faced a challenging year due to increased competition. Stent Co has a year end of 30 September 20X9 and the unaudited draft financial statements report an operating loss. In addition to this, debt covenant limits based on gearing are close to being breached and the company is approaching its overdraft limit.

Cash advance from Budster Co

On 27 September 20X9, Stent Co's finance director asked the accountant to record a cash advance of \$3 million received from a customer, Budster Co, as a reduction in trade receivables. Budster Co is solely owned by Stent Co's finance director. The accountant has seen an agreement signed by both companies stating that the \$3 million will be repaid to Budster Co in four months' time. The finance director argues that the proposed accounting treatment is acceptable because the payment has been made in advance in case Budster Co wishes to order goods in the next four months. However, the accountant has seen no evidence of any intent from Budster Co to place orders with Stent Co. (4 marks)

Preference shares

On 1 October 20X8, the CEO and finance director each paid \$2 million cash in exchange for preference shares from Stent Co which provide cumulative dividends of 7% per annum. These preference shares can either be converted into a fixed number of ordinary shares in two years' time, or redeemed at par on the same date, at the choice of the holder. The finance director suggests to the accountant that the preference shares should be classified as equity because the conversion is into a fixed number of ordinary shares on a fixed date ('fixed for fixed') and conversion is certain (given the current market value of the ordinary shares).

(4 marks)**Deferred tax asset**

Stent Co includes a deferred tax asset in its statement of financial position, based on losses incurred in the current and the previous two years. The finance director has asked the accountant to include the deferred tax asset in full. He has suggested this on the basis that Stent Co will return to profitability once its funding issues are resolved.

(3 marks)**Required:**

- (a) Discuss appropriate accounting treatments which Stent Co should adopt for all issues identified above and their impact upon gearing.

Note: The mark allocation is shown against each issue above.

The accountant has been in her position for only a few months and the finance director has recently commented that 'all these accounting treatments must be made exactly as I have suggested to ensure the growth of the business and the security of all our jobs'. Both the finance director and the accountant are fully qualified members of ACCA.

Required:

- (b) Discuss the ethical issues arising from the scenario, including any actions which the accountant should take to resolve the issues.

(7 marks)

Professional marks will be awarded in this question for the application of ethical principles.

(2 marks)**(Total: 20 marks)**

Calculate your allowed time, allocate the time to the separate parts.....

26 HUDSON (MAR/JUN 2019)***Walk in the footsteps of a top tutor*****Background**

Hudson has a year end of 31 December 20X2 and operates a defined benefit scheme for all employees. In addition, the directors of Hudson are paid an annual bonus depending upon the earnings before interest, tax, depreciation and amortisation (EBITDA) of Hudson.

Hudson has been experiencing losses for a number of years and its draft financial statements reflect a small loss for the current year of \$10 million. On 1 May 20X2, Hudson announced that it was restructuring and that it was going to close down division Wye. A number of redundancies were confirmed as part of this closure with some staff being reallocated to other divisions within Hudson. The directors have approved the restructuring in a formal directors' meeting. Hudson is highly geared and much of its debt is secured on covenants which stipulate that a minimum level of net assets should be maintained. The directors are concerned that compliance with IFRS Standards could have significant implications for their bonus and debt covenants.

Redundancy and settlement costs

Hudson still requires a number of staff to operate division Wye until its final expected closure in early 20X3. As a consequence, Hudson offered its staff two packages in relation to the curtailment of the defined benefit scheme. A pension enhancement was offered for all staff who leave before the final closure of division Wye. An additional pension enhancement was offered for staff who remained in employment until the final closure of division Wye. The directors of Hudson have only included an adjustment in the financial statements for those staff who left prior to 31 December 20X2. The directors have included this adjustment within the remeasurement component of the defined benefit scheme. They do not wish to provide for any other enhancements until employment is finally terminated, arguing that an obligation would only arise once the staff were made redundant. On final termination, the directors intend to include the remaining basic enhancement and the additional pension enhancement within the remeasurement component.

The directors and accountant are aware that the proposed treatment does not conform to IFRS Standards. The directors believe that the proposed treatment is justified as it will help Hudson maintain its debt covenant obligations and will therefore be in the best interests of their shareholders who are the primary stakeholder. The directors have indicated that, should the accountant not agree with their accounting treatment, then he will be replaced.

Tax losses

The directors of Hudson wish to recognise a material deferred tax asset in relation to \$250 million of unused trading losses which have accumulated as at 31 December 20X2. Hudson has budgeted profits for \$80 million for the year ended 31 December 20X3. The directors have forecast that profits will grow by 20% each year for the next four years. The market is currently depressed and sales orders are at a lower level for the first quarter of 20X3 than they were for the same period in any of the previous five years. Hudson operates under a tax jurisdiction which allows for trading losses to be only carried forward for a maximum of two years.

Required:

- (a) Explain why the directors of Hudson are wrong to classify the basic and additional pension enhancements as part of the remeasurement component, including an explanation of the correct treatment for each of these items. Also explain how any other restructuring costs should be accounted for. (8 marks)
- (b) Explain whether a deferred tax asset can be recognised in the financial statements of Hudson in the year ended 31 December 20X2. (5 marks)
- (c) Identify any ethical issues which arise from the directors' proposed accounting treatments and behaviour. Your answer should also consider the implications for the accountant arising from the directors' behaviour. (5 marks)

Professional marks will be awarded in part (c) for quality of discussion. (2 marks)

(Total: 20 marks)

27 FISKERTON (DEC 2018)

*Walk in the footsteps of a top tutor***Background**

The following is an extract from the statement of financial position of Fiskerton, a public limited entity as at 30 September 20X8.

	\$000
Non-current assets	160,901
Current assets	110,318
Equity share capital (\$1 each)	10,000
Other components of equity	20,151
Retained earnings	70,253
Non-current liabilities (bank loan)	50,000
Current liabilities	120,815

The bank loan has a covenant attached whereby it will become immediately repayable should the gearing ratio (long-term debt to equity) of Fiskerton exceed 50%. Fiskerton has a negative cash balance as at 30 September 20X8.

Halam property

Included within the non-current assets of Fiskerton is a property in Halam which has been leased to Edingley under a 40-year lease. The property was acquired for \$20 million on 1 October 20X7 and was immediately leased to Edingley.

The asset was expected to have a useful life of 40 years at the date of acquisition and have a minimal residual value. Fiskerton has classified the building as an investment property and has adopted the fair value model.

The property was initially revalued to \$22 million on 31 March 20X8. Interim financial statements had indicated that gearing was 51% prior to this revaluation. The managing director was made aware of this breach of covenant and so instructed that the property should be revalued. The property is now carried at a value of \$28 million which was determined by the sale of a similar sized property on 30 September 20X8. This property was located in a much more prosperous area and built with a higher grade of material. An independent professional valuer has estimated the value to be no more than \$22 million. The managing director has argued that fair values should be referenced to an active market and is refusing to adjust the financial statements, even though he knows it is contrary to international accounting standards.

Sales contract

Fiskerton has entered into a sales contract for the construction of an asset with a customer whereby the customer pays an initial deposit. The deposit is refundable only if Fiskerton fails to complete the construction of the asset. The remainder is payable on delivery of the asset. If the customer defaults on the contract prior to completion, Fiskerton has the right to retain the deposit. The managing director believes that, as completion of the asset is performed over time, revenue should be recognised accordingly. He has persuaded the accountant to include the deposit and a percentage of the remaining balance for construction work in revenue to date.

Required:

- (a) Discuss how the Halam property should have been accounted for and explain the implications for the financial statements and the debt covenant of Fiskerton. (7 marks)
- (b) In accordance with IFRS 15 *Revenue from Contracts with Customers*, discuss whether revenue arising from the sales contract should be recognised on a stage of completion basis. (4 marks)
- (c) Explain any ethical issues which may arise for the managing director and the accountant from each of the scenarios. (7 marks)

Professional marks will be awarded in part (c) for the quality of the discussion.

(2 marks)

(Total: 20 marks)

28 FARHAM (SEP 2018)



Walk in the footsteps of a top tutor

Background

Farham manufactures white goods such as washing machines, tumble dryers and dishwashers. The industry is highly competitive with a large number of products on the market. Brand loyalty is consequently an important feature in the industry. Farham operates a profit related bonus scheme for its managers based upon the consolidated financial statements but recent results have been poor and bonus targets have rarely been achieved. As a consequence, the company is looking to restructure and sell its 80% owned subsidiary Newall which has been making substantial losses. The current year end is 30 June 20X8.

Factory subsidence

Farham has a production facility which started to show signs of subsidence since January 20X8. It is probable that Farham will have to undertake a major repair sometime during 20X9 to correct the problem. Farham does have an insurance policy but it is unlikely to cover subsidence. The chief operating officer (COO) refuses to disclose the issue at 30 June 20X8 since no repair costs have yet been undertaken although she is aware that this is contrary to international accounting standards. The COO does not think that the subsidence is an indicator of impairment. She argues that no provision for the repair to the factory should be made because there is no legal or constructive obligation to repair the factory.

Farham has a revaluation policy for property, plant and equipment and there is a balance on the revaluation surplus of \$10 million in the financial statements for the year ended 30 June 20X8. None of this balance relates to the production facility but the COO is of the opinion that this surplus can be used for any future loss arising from the subsidence of the production facility. (5 marks)

Sale of Newall

At 30 June 20X8 Farham had a plan to sell its 80% subsidiary Newall. This plan has been approved by the board and reported in the media. It is expected that Oldcastle, an entity which currently owns the other 20% of Newall, will acquire the 80% equity interest. The sale is expected to be complete by December 20X8. Newall is expected to have substantial trading losses in the period up to the sale. The accountant of Farham wishes to show Newall as held for sale in the consolidated financial statements and to create a restructuring provision to include the expected costs of disposal and future trading losses. The COO does not wish Newall to be disclosed as held for sale nor to provide for the expected losses. The COO is concerned as to how this may affect the sales price and would almost certainly mean bonus targets would not be met. The COO has argued that they have a duty to secure a high sales price to maximise the return for shareholders of Farham. She has also implied that the accountant may lose his job if he were to put such a provision in the financial statements. The expected costs from the sale are as follows:

	\$m
Future trading losses	30
Various legal costs of sale	2
Redundancy costs for Newall employees	5
Impairment losses on owned assets	8

Included within the future trading losses is an early termination penalty of \$6 million for a leased asset which is deemed surplus to requirements. (6 marks)

Required:

- (a) Discuss the accounting treatment which Farham should adopt to address each of the issues above for the consolidated financial statements.

Note: The mark allocation is shown against each of the two issues above.

- (b) Discuss the ethical issues arising from the scenario, including any actions which Farham and the accountant should undertake. (7 marks)

Professional marks will be awarded in part (b) for the quality of the discussion. (2 marks)

(Total: 20 marks)

29 CLOUD Walk in the footsteps of a top tutor



Answer debrief

Background

Cloud, a public limited company, is preparing financial statements for the year ended 31 December 20X1. The profit figure reported in the interim financial statements was lower than shareholders expected, and net operating cash flows for the year are below budget. The directors of Cloud receive a bonus if Cloud's operating cash flow and profit before tax exceed a predetermined target for the year. The finance director is perceived to be a dominant personality, and members of the accounts department, many of whom are ACCA members, follow his instructions without question.

Presentation of loan in statement of cash flows

Cloud has entered into a long-term contract with a major customer and negotiated a new bank loan on the strength of this contract. The proceeds of the loan were received in the current period and are to be repaid over four years to 31 December 20X5. Cloud has reported the loan proceeds as an operating cash flow because it relates to a long-term trading contract.

Share sale

During the period Cloud sold 5% of the equity shares of Fog for \$2 million. Prior to the sale, Cloud owned 100% of the shares of Fog. This transaction has improved Cloud's cash position while enabling it to retain control over Fog. At the date of the share sale, the goodwill and net assets of Fog were carried in the consolidated statement of financial position at \$5 million and \$25 million respectively. The non-controlling interest at acquisition was measured at fair value. Cloud has recorded a profit on the disposal of the shares in the consolidated statement of profit or loss.

Revaluation of property, plant and equipment

Cloud purchased an item of property, plant and equipment for \$10 million on 1 January 20X0. The useful economic life was estimated to be five years. At 31 December 20X0, the asset was revalued to \$12 million. At 31 December 20X1, the asset's value had fallen to \$4 million. The downwards revaluation was recorded in other comprehensive income.

Required:

Explain, with suitable calculations, how the above transactions should be dealt with in the financial statements for the year ended 31 December 20X1 and discuss the ethical and professional issues raised. (18 marks)

Professional marks will be awarded in this question for the application of ethical principles. (2 marks)

(Total: 20 marks)



Calculate your allowed time, allocate the time to the separate parts.....

30 GARDEN *Walk in the footsteps of a top tutor*

Background

Garden is a public listed company with a reporting date of 30 November 20X6. It owns and operates various online businesses. Its customers order goods through Garden's websites, and these goods are delivered by third party couriers. At 30 November 20X6, the finance director owns 15% of Garden's ordinary shares and the operations director owns 10%. The rest of the shares are owned by numerous other shareholders. All ordinary shares carry equal voting rights. At the most recent annual general meeting, some of the shareholders expressed dis-satisfaction with the financial performance of Garden. They also complained that the directors were overpaid and were not demonstrating effective stewardship of the company's assets. The accountant of Garden started her employment during the year ended 30 November 20X6 and has encountered a number of issues.

Share-based payment

On 1 December 20X5, a share-based payment scheme was introduced for Garden's six directors. The directors are entitled to 600,000 share options each if they remain employed by the company until 30 November 20X8. The fair value of each share option was \$4 at 1 December 20X5 and \$5 at 30 November 20X6. At 1 December 20X5 it was estimated that none of the directors would leave before the end of three years but, as at 30 November 20X6, the estimated number of leavers was revised to one. The finance director has told the accountant that no entries or disclosures are required for this scheme in the current year's financial statements because it has not yet vested. **(4 marks)**

The directors' son

The wife of the finance director is the sales director of Garden. Their son is undertaking an internship with Garden and receives a salary of \$30,000 per annum, which is in line with market rates. The finance director has ordered the accountant to omit any reference to his son's salary from the financial statements. **(3 marks)**

Operating segments

At the start of the current year, Garden purchased the trade and assets of a fashion retail chain that operates a number of shops in large towns and cities. The chain did not sell its products online. The press were critical of Garden's decision, accusing them of over-paying for the chain and of expanding into a sector in which they lack experience and expertise. The performance of the shops, which is monitored internally by Garden's chief operating decision makers, has been poor. When reviewing the operating segment disclosure note prepared by the finance director the accountant noticed that the new retail business has been aggregated with the rest of Garden's trading operations and disclosed as a single reportable segment. The gross profit margins made from the retail outlets are much lower than those made from Garden's online operations. From overhearing conversations, the accountant is aware that Garden's finance director is a good friend of the former owner of the retail chain. **(4 marks)**

Required:

- (a) Discuss the correct accounting treatment of the above three issues in Garden's financial statements for the year ended 30 November 20X6.

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

- (b) Discuss the accounting and ethical implications of the above from the perspective of the accountant. **(7 marks)**

Professional marks will be awarded in part (b) for the application of ethical principles. **(2 marks)**

(Total: 20 marks)

31 CHERRY *Walk in the footsteps of a top tutor*

Background

Cherry is a large public limited company. It prepares its financial statements using IFRS Standards and has a reporting date of 30 November 20X6. A bonus is paid to the directors each year which is based upon the operating profit margin of Cherry.

Change in accounting policy for pension scheme

On 1 December 20X5, there was an amendment to Cherry's defined benefit scheme whereby the promised pension entitlement was increased from 10% of final salary to 15%. The directors believe that the pension scheme, which is in deficit, is not an integral part of the operating activities of Cherry. As such they have changed their accounting policy so that, from the current year, all gains and losses on the pension scheme are recognised in other comprehensive income. They believe that this will make the financial statements more consistent, more understandable and can be justified on the grounds of fair presentation.

(3 marks)**Trademark**

On 1 December 20X2, Cherry acquired a trademark, Golfo, for a line of golf clothing for \$3 million. Initially, because of the difficulty in determining its useful life, Cherry decided to amortise the trademark over a 10-year life, using the straight-line method. On 1 December 20X5, a competitor unexpectedly revealed a technological breakthrough which is expected to result in a product which, when launched in May 20X8, will significantly reduce the demand for the Golfo product-line. Cherry now intends to continue manufacturing Golfo products until 31 May 20X8. Amortisation of \$300,000 in relation to the Golfo trademark has been charged in the financial statements for the year ended 30 November 20X6.

(4 marks)**Sale and leaseback**

Cherry sold a building for its fair value of \$5 million to a finance company on 30 November 20X6 when its carrying amount was \$3.5 million. The building was leased back from the finance company for a period of 5 years. The remaining useful life of the building was deemed to be 25 years so it can be concluded that control of the building has transferred to the finance company. Lease rentals are \$440,000 payable annually in arrears. The interest rate implicit in the lease is 7%. The present value of the annual lease payments is \$1.8 million. Cherry has recorded the cash proceeds, derecognised the building, and recorded a profit on disposal of \$1.5 million in the statement of profit or loss. No other accounting entries have been posted.

The directors have told the financial controller that the accounting treatments outlined above are correct. Any further time that the financial controller spends reviewing these transactions will be looked on unfavourably when deciding her bonus for the year.

(5 marks)**Required:**

- (a) Discuss the correct accounting treatment of the above transactions in the financial statements of Cherry for the year ended 30 November 20X6.

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

- (b) Discuss the ethical implications of the above scenario. **(6 marks)**

Professional marks will be awarded in part (b) for the application of ethical principles. **(2 marks)**

(Total: 20 marks)

32 ANOUK

Background

Anouk is a public limited entity with a reporting date of 31 December 20X1. It has covenants attached to some of the bank loan balances included within liabilities on its statement of financial position. The covenants create a legal obligation to repay the loans in full if Anouk's liabilities exceed a specified level. A new financial controller was appointed in January 20X2 and has discovered some financial reporting issues in relation to the year ended 31 December 20X1.

Receivables factoring

On 31 December 20X1 Anouk sold some of its trade receivables to a debt factor. The factor advanced 20% of the \$40 million receivables sold. Further amounts become payable to Anouk but are subject to an imputed interest charge so that Anouk receives progressively less of the remaining balance the longer it takes the factor to recover the funds. The factor has full recourse to Anouk for a six-month period after which Anouk has no further obligations and has no rights to receive any further payments from the factor.

The directors are concerned about the negative impact that any potential debt factoring arrangements may have on its loan covenants. As such, they have ordered the financial controller to treat the factoring arrangement in accordance with its legal form.

B-shares

One of Anouk's subsidiaries, Vianne, has two classes of shares: A and B. A-shares carry voting powers and B-shares are issued to meet regulatory requirements. Vianne's shareholder agreement stipulates that the minority B shareholders can exercise a put option every three years which requires Anouk to buy their shares. The exercise price is the original cost paid by the shareholders. In Anouk's consolidated statement of financial position, the B-shares owned by minority shareholders are reported in equity as a non-controlling interest.

Crane

On the 31 December 20X1, Anouk signed a contract to use a crane for the next five years. The supplier of the crane is permitted to substitute the crane for an alternative model during the period of use, and is required to do so if the crane develops a fault. Due to the size of the crane, the supplier would have to incur significant costs to substitute it. The contract states that Anouk can use the crane for any construction activities it wishes. However, the contract also states that the crane cannot be used if wind speed exceeds 14 metres per second. Anouk must pay a fixed monthly rental fee for use of the crane. Anouk has posted no accounting entries in respect of this contract. The financial controller found this contract by accident and suspects that the directors had attempted to conceal it.

Required:

Discuss the accounting and ethical implications of the above. (18 marks)

Professional marks will be awarded in this question for the application of ethical principles. (2 marks)

(Total: 20 marks)

SECTION B QUESTIONS

33 STEM (SEP/DEC 2021) *Walk in the footsteps of a top tutor*

Stem Co is a manufacturing company and is considering providing cars for its senior management. It has also entered into an agreement with two other companies to develop a new technology through a separate legal entity, Emphasis Co. The financial year end of Stem Co is 31 December 20X7.

Company cars

On 1 January 20X7, Stem Co is considering providing company cars for its senior management and is comparing three options.

Option 1

The cars can be leased for a period of four years starting on 1 January 20X7. The cars have a total market value of \$75,274 on this date. The lease requires payments of \$1,403 on a monthly basis for the duration of the lease term of which \$235 is a servicing charge. Stem Co wishes to show the servicing charge as a separate line item in profit or loss.

At the end of the four-year period, there is no option to renew the lease or purchase the cars, and there is no residual value guarantee. The interest to be charged for the year ended 31 December 20X7 is correctly calculated at \$2,274 based upon the implicit interest rate in the lease. The net present value of the lease payments over four years is \$50,803 excluding the service charge.

Option 2

The cars can be purchased for \$75,274 with a 100% bank loan. The cars would be purchased on 1 January 20X7 and held for four years. The estimated residual value is \$29,753. Monthly service costs would still be \$235 per month. The loan would be repayable in four annual instalments commencing 1 January 20X8. Assume that an average annual percentage rate on a loan is 5%.

Option 3

A final alternative is to lease the cars with a 12-month agreement on 1 January 20X7 with no purchase option. The cost would be \$1,900 per month in advance including servicing charge. Stem Co would take advantage of the short-term lease exemption under IFRS 16 Leases.

Other relevant information

The profit before tax and before accounting for any of the three options for cars is likely to be \$100,000 for the year ended 31 December 20X7. Stem Co depreciates cars over a four-year period using straight line depreciation.

Emphasis Co

On 1 January 20X7, Stem Co has contributed cash to a new legal entity, Emphasis Co, and holds an interest of 40%. The other two companies contributing have retained equity interests of 40% and 20%, respectively. The purpose of the entity is to share risks and rewards in developing a new technology. The holders of a 40% interest can appoint three members each to a seven-member board of directors. All significant decisions require the unanimous consent of the board. The holder of the 20% interest can appoint only one board member and can only participate in the significant decisions of the entity through the board. There are no related parties.

Stem Co contributed cash of \$150,000 to Emphasis Co. The entity will use the cash invested by Stem Co to gain access to new markets and to develop new products. At 1 January 20X7, the carrying amount of the net assets contributed by the three companies was \$310,000 but the fair value of the net assets contributed was \$470,000.

Required:

- (a) Explain, with suitable calculations, the impact of the three alternative company car options on:
- earnings before interest, tax, depreciation and amortisation (EBITDA)
 - profit before tax, and
 - the statement of financial position for the year ended 31 December 20X7.

Note: Candidates should refer to IFRS 16 *Leases* where appropriate. (13 marks)

- (b) (i) Discuss briefly principles of the equity method of accounting and whether it is a more relevant measurement basis than cost or fair value of an investment in an associate company.

Note: There is no need to refer to any exhibit when answering part (b)(i). (4 marks)

- (ii) Discuss why Stem Co's investment in Emphasis Co should be classified as a joint venture and how Stem Co should account for its interest at 1 January 20X7 in accordance with IAS 28 *Investments in Associates and Joint Ventures*.

Note: Candidates should show any relevant entries required in the accounting records of Stem Co. (8 marks)

(Total: 25 marks)

34 SYMBAL (SEP/DEC 2021)



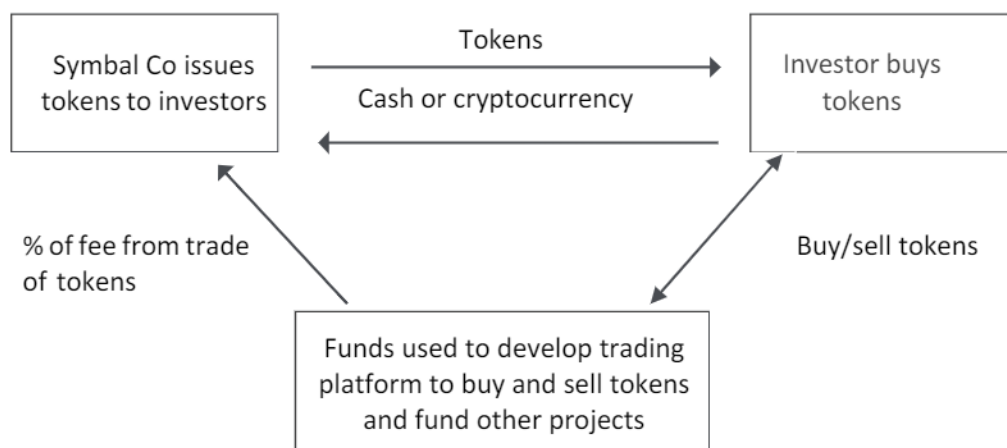
Walk in the footsteps of a top tutor

Symbal Co develops cryptocurrency funds and is a leading authority on crypto investing. Symbal Co specialises in Initial Coin Offerings ('ICO') that raises funds from investors in the form of cash or a crypto asset such as Bitcoin.

The year-end of Symbal Co is 31 March 20X7.

Development costs

The diagram below illustrates how the ICO is used by Symbal Co.



Note: The terms token and coin mean the same and investors are often referred to as supporters.

An ICO issues tokens to investors for cryptocurrency or cash. For each ICO, Symbal Co establishes a separate payment platform on which the investors can trade the tokens. These tokens do not represent an ownership interest in the entity. Symbal Co promises to produce gains for investors from trading the tokens on the platform and in return, the company takes a percentage of the profit as a fee.

As at 31 March 20X7, Symbal Co has incurred significant cost in promoting the issue of the ICO tokens, and developing the trading platform for dealing with the purchase and sale of the ICO tokens. These costs have been met from its own capital and expensed to profit or loss. Symbal Co will earn revenue from supporting the purchase and sale of tokens.

ICO arrangements

Occasionally, Symbal Co enters into pre-sale agreements to raise funding from selected investors prior to a public sale of tokens. Symbal Co has entered into a pre-sale agreement with an investor which entitles the investor to a 10% discount on the price for tokens compared to other investors at the time of the ICO. On 1 March 20X7, the investor paid Symbal Co \$1 million in cash. The issue date of the ICO is 30 April 20X7. The cash is only refundable if the ICO is abandoned before 30 April 20X7 because the minimum funding level of \$9 million has not been achieved.

Once the tokens are issued, ICO investors can readily convert them into cash or cryptocurrencies on Symbal Co's platform but they do not entitle the holder to future goods and services from Symbal Co other than supporting the purchase and sale of tokens. The inflows received for tokens are used by Symbal Co to fund the future development of the payment platform and other projects.

In order to induce investment in the ICO, Symbal Co has made a commitment to the holders of tokens to pay a single payment of 10% of any annual profit for the year ended 31 March 20X8. The holders do not have any other rights such as redemption of their tokens or any residual interest in the assets of Symbal Co.

The ICO raised \$10 million on 30 April 20X7.

Tokens granted to directors

Symbal Co sometimes does not issue all the tokens from an ICO to investors but retains some to use to reward their employees. On 1 March 20X7, Symbal Co granted tokens to its five directors from the issue on 30 April 20X7. The award vests on 31 March 20X7 to directors who were in Symbal Co's employment at 31 March 20X7. The tokens give the directors the right to receive a car of their choice up to a value of \$50,000 at any time in the next 12 months to 31 March 20X8 if they remain as directors of Symbal Co. All five directors were still with Symbal Co on 31 March 20X7.

Required:

- (a) Explain the principles of good disclosure which should be used to inform investors regarding the company's holding of crypto assets.**

Note: There is no need to refer to any exhibit when answering part (a). **(6 marks)**

Professional marks will be awarded in part (a) for clarity and quality of discussion. **(2 marks)**

- (b) Advise whether the various development and promotional costs related to the ICO can be accounted for as an intangible asset at 31 March 20X7.** **(5 marks)**

- (c) Discuss how the receipt of \$1 million cash in the pre-sale agreement should be accounted for in the financial statements for the year ended 31 March 20X7 and how the \$10 million raised in the ICO should be accounted for in the financial statements for the year ended 31 March 20X8. (6 marks)
- (d) Discuss why the granting of the tokens to the five directors should be accounted for in accordance with IAS 19 *Employee Benefits* rather than IFRS 2 *Share-based Payment* in the financial statements for the year ended 31 March 20X7. (6 marks)
- (Total: 25 marks)

35 SITKA (MAR/JUN 2021) *Walk in the footsteps of a top tutor*

Sitka Co is a software development company which operates in an industry where technologies change rapidly. Its customers use the cloud to access the software and Sitka Co generates revenue by charging customers for the software license and software updates. It has recently disposed of an interest in a subsidiary, Marlett Co, and purchased a controlling interest in Billing Co. The year end of the company is 31 December 20X7.

Software contract and updates

On 1 January 20X7, Sitka Co agreed a four-year contract with Cent Co to provide access to licence Sitka Co's software including customer support in the form of monthly updates to the software. The total contract price is \$3 million for both licensing the software and the monthly updates. Sitka Co licenses the software on a stand-alone basis for between \$1 million and \$2 million over a four-year period and regularly sells the monthly updates separately for \$2.5 million over the same period. The software can function on its own without the updates. Although, the monthly updates improve its effectiveness, they are not essential to its functionality. However, because of the rapidly changing technology in the industry, if Cent Co does not update the software regularly, the benefits of using the software would be significantly reduced. In the year to 31 December 20X7, Cent Co has only updated the software on two occasions. Cent Co must access the software via the cloud and does not own the rights to the software.

Part-disposal of Marlett Co

Sitka Co prepares separate financial statements in accordance with IAS 27 *Separate Financial Statements*. At 31 December 20X6, it held a 60% controlling equity interest in Marlett Co and accounted for Marlett Co as a subsidiary. In its separate financial statements, Sitka Co had elected to measure its investment in Marlett Co using the equity method. On 1 July 20X7, Sitka Co disposed of 45% of its equity interest in Marlett Co for \$10 million and lost control. At the date of disposal, the carrying amount of Marlett Co in its separate financial statements was \$12 million. After the partial disposal, Sitka Co does not have joint control of, or significant influence over Marlett Co and its retained interest of 15% is to be treated as an investment in an equity instrument. At 1 July 20X7, the fair value of the retained interest of 15% in Marlett Co was \$3.5 million. Sitka Co wishes to recognise any profit or loss on the disposal of the 45% interest in other comprehensive income.

Acquisition of Billing Co

Sitka Co has acquired two assets in a business combination with Billing Co. The first asset is 'Qbooks' which is an accounting system developed by Billing Co for use with the second asset which is 'Best Cloud' software. The directors of Sitka Co believe that the fair value of the assets is higher if valued together rather than individually. If the assets were to be sold, there are two types of buyers that would be interested in purchasing the assets. One buyer group would be those who operate in the same industry and have similar assets. This group of buyers would eventually replace Qbooks with their own accounting system which would enhance the value of their assets. The fair values of the individual assets in the industry buyer group would be \$30 million for Qbooks and \$200 million for 'Best Cloud', therefore being \$230 million in total. Another type of buyer is the financial investor who would not have a substitute asset for Qbooks. They would licence Qbooks for its remaining life and commercialise the product. The indicated fair values for Qbooks and Best Cloud within the financial investor group are \$50million and \$150 million, being \$200 million in total.

Required:

- (a) (i) Discuss whether the four-year software contract with Cent Co is a single performance obligation in accordance with IFRS 15 *Revenue from Contracts with Customers* including how the revenue from the contract would be accounted for in Sitka Co's financial statements for the year ended 31 December 20X7. Your answer should include whether the revenue should be recognised at a point in time or over time. (8 marks)
 - (ii) Discuss briefly why the right to receive access to Sitka Co's software is unlikely to be accounted for as an intangible asset or a lease in Cent Co's financial statements. (4 marks)
 - (b) Discuss and demonstrate how the disposal of 45% interest and the retained interest of 15% in Marlett Co should be accounted for in the separate financial statements of Sitka Co at the date of disposal. (9 marks)
 - (c) Discuss how the two assets acquired on the acquisition of Billing Co should be valued in accordance IFRS 13 *Fair Value Measurement*. (4 marks)
- (Total: 25 marks)

36 COLAT (MAR/JUNE 2021)***Walk in the footsteps of a top tutor***

Colat Co manufactures aluminium products and operates in a region that has suffered a natural disaster on 1 November 20X7. There has been an increase in operating costs as the company had to replace a regional supplier with a more costly international supplier. The year-end of Colat Co is 31 December 20X7.

Non-current assets

As a result of the natural disaster, the share price of Colat Co has declined as a significant amount of non-current assets were destroyed, including the manufacturing facility. In addition, Colat Co has suffered reputational damage resulting in a decline in customer demand. The non-current assets of Colat Co that were destroyed had a carrying amount of \$250 million on 31 October 20X7 and the fair value of these non-current assets was \$280 million based on an independent appraisal shortly before that date. In addition, Colat Co determined that a power plant will have to be closed and decommissioned earlier than previously expected. The remaining useful life of the power plant has reduced from 25 years to 8 years. Non-current assets are valued using the cost model.

Other natural disaster consequences**Environmental damage and government compensation**

Colat Co has, in the past, repaired minor environmental damage that it has caused but it has never suffered a natural disaster on this scale. There is no legal obligation for Colat Co to repair and restore damage caused by the disaster as this will be the responsibility of the government.

The government announced on 1 December 20X7 that there would be compensation of \$50 million available to repair the environmental damage only and that companies should apply for the compensation by 31 December 20X7. By 1 March 20X8, when the financial statements were approved, Colat Co had only received an acknowledgement of their application but no approval.

Hedge of commodity price risk in aluminium

Colat Co hedges commodity price risk in aluminium and such transactions were classified as 'highly probable' in accordance with IFRS 9 *Financial Instruments*. However, the purchases which were considered highly probable prior to the natural disaster, are no longer expected to occur.

Potential insurance policy proceeds

Colat Co's insurance policy provides compensation for losses based on the fair value of non-current assets, any temporary relocation costs estimated at \$2million and any revenue lost during the two-month period from 1 November 20X7. At 31 December 20X7, it is unclear which events and costs are covered by insurance policies and significant uncertainty exists as to whether any compensation will be paid. Before the financial statements were approved, it was probable that the insurance claim for the loss of the non-current assets would be paid but no further information was available about other insured losses.

The insurance policy does not cover environmental damage which is the responsibility of the government.

Required (25 marks):

Investors need to understand a variety of factors when making an investment decision. The nature of the companies in which they are looking to invest is an important consideration, as is the need to incorporate sustainability factors into investment decisions.

- (a) Discuss why sustainability has become an important aspect of the investors' analysis of companies.**

Note: there is no requirement to refer to any exhibit when answering part (a). **(4 marks)**

Professional marks will be awarded in part (a) for clarity and quality of discussion. **(2 marks)**

- (b) Discuss any events affecting Colat Co which might indicate that an impairment test ought to be conducted in accordance with IAS 36 *Impairment of Non-Current Assets*.** **(3 marks)**

- (c) Discuss how the following should be accounted for in the financial statements for the year ended 31 December 20X7:**

- (i) the destruction of the non-current assets and decommissioning of the power plant** **(4 marks)**
- (ii) the cost of repairing the environmental damage and the potential receipt of government compensation** **(4 marks)**
- (iii) the hedge of the commodity price risk in aluminium, and** **(4 marks)**
- (iv) the potential insurance policy proceeds.** **(4 marks)**

(Total: 25 marks)

37 CORBEL (SEP/DEC 2020)***Walk in the footsteps of a top tutor***

Corbel Co trades in the perfume sector. It has recently acquired a company for its brand 'Jengi', purchased two additional brand names, and has announced plans to close its Italian stores. Corbel Co also opened a new store on a prime site in Paris. The current financial year end is 31 December 20X7.

Acquisition of Jengi Co

On 1 January 20X7, Corbel Co acquired 100% of Jengi Co. Both companies operate in the perfume sector. Corbel Co intends to merge the manufacture of Jengi Co's products into its own facilities and close Jengi Co's manufacturing unit. Jengi Co's brand name is well known in the sector, retailing at premium prices, and therefore, Corbel Co will continue to sell products under the Jengi brand name after its registration has been transferred and its manufacturing units have been integrated. The directors of Corbel Co believe that most of the value of Jengi Co was derived from the brand and there is no indication of the impairment of the brand at 31 December 20X7.

Acquisition of perfume brands

In addition to now owning the Jengi Co brand, Corbel Co has acquired two other perfume brand names to prevent rival companies acquiring them. The first perfume (Locust) has been sold successfully for many years and has an established market. The second is a new perfume which has been named after a famous actor (Clara) who intends to promote the product. The directors of Corbel Co believe that the two perfume brand names have an indefinite life.

Plan to close and sell stores

Corbel Co approved and announced a plan to close and sell all six Italian stores on 31 December 20X7. The six stores will close after a liquidation sale which will last for three months. Management has committed to a formal plan for the closure of the six stores and has also started an active search for a single buyer for their assets. The stores are being closed because of the increased demand generated by Corbel Co's internet sales.

A local newspaper has written an article suggesting that up to 30 stores may be closed with a loss of 500 jobs across the world, over the next five years. The directors of Corbel have denied that this is the case.

Corbel Co's primary store

Corbel Co's primary store is located in central Paris. It has only recently been opened at a significant cost with the result that management believes it will make a loss in the current financial year to 31 December 20X7. This loss-making is not of concern as the performance is consistent with expectations for such a new and expensive store and management believes that the new store will have a positive effect on Corbel Co's brand image.

If impairment testing of the primary store were to be required, then Corbel Co would include the cash flows from all internet sales in this assessment. The goods sold via the internet are sourced from either Corbel Co's central distribution centre or individual stores. Internet sales are either delivered to the customer's home or collected by the customer from the store supplying the goods.

Required:

- (a) Describe the main challenges in recognising and measuring intangible assets, such as brands, in the statement of financial position. (5 marks)
- (b) Discuss the following accounting issues relating to Corbel Co's financial statements for the year ended 31 December 20X7 in accordance with IFRS standards:
 - (i) whether the Jengi Co brand name will be accounted for separately from goodwill on acquisition and whether it should be accounted for as a separate cash generating unit after the integration of the manufacturing units (4 marks)
 - (ii) how to account for intangible assets with an indefinite life and whether the Locust and Clara perfume brand names can be regarded as having an indefinite life (6 marks)
 - (iii) how to account for the proposed closure of the six stores and the suggested closure of the remaining stores; and (6 marks)
 - (iv) whether the primary store should be tested for impairment at 31 December 20X7 and whether the internet sales can be attributed to this store. (4 marks)

(Total: 25 marks)**38 HANDFOOD (SEP/DEC 2020)*****Walk in the footsteps of a top tutor***

Handfood Co is a small and medium-sized enterprise (SME) which has introduced a benefit to encourage employees to remain with the entity. The company's financial year end is 31 December and it prepares its financial statements using IFRS Standards but is interested in the differences with the SMEs Standard.

SMEs

It can be argued that small and medium-sized enterprises (SMEs) face financing difficulties because there is serious information asymmetry between SMEs and investors. Information asymmetry, in the context of SMEs, means that the SME has access to relevant information, while the investor suffers from a lack of relevant information. It can be argued that the SMEs Standard decreases information asymmetry between the entity and investors.

Where SMEs lead in product and service innovation, they can also lead in innovation for integrated reporting. There is a clear, concise and persuasive case for why SMEs and their stakeholders stand to benefit greatly by using integrated reporting.

Employee benefit

On 1 January 20X2, Handfood Co introduced a benefit to encourage employees to remain in its employment for at least five years. Handfood Co has promised its employees a lump-sum benefit, payable on 1 January 20X7, which is equal to 1% of their salary at 31 December 20X6, provided they remain employed until that date.

The current salaries of employees on 1 January 20X2 are \$1.1 million per annum. The directors of Handfood Co have used the following assumptions:

- Salaries for year ended 31 December 20X2 will remain at \$1.1 million.
- Salaries should increase by 3% each year from 1 January 20X3.
- There is a 75% probability that all employees will still be employed by Handfood Co at 31 December 20X6.

The discount rate is 5% per year.

Handfood Co recognises actuarial gains and losses in other comprehensive income. Interest is recognised by Handfood Co on an annual basis. Handfood Co uses the projected unit credit method to measure its benefit obligations which means that the current service cost is the increase in the present value of the future benefit liabilities. The benefit will be payable from the balance on Handfood Co's business bank account at 1 January 20X7.

Present value factors	5%
Periods (years)	
4	0.823
5	0.784

Required:

- (a) (i) Discuss the nature of the SMEs Standard and the principal differences between the SMEs Standard and full IFRS Standards. (4 marks)
- (ii) Discuss the effect that information asymmetry can have on the decision to invest in SMEs. (4 marks)
- (iii) Discuss how integrated reporting could help SMEs better understand and better communicate how they create value to investors. (5 marks)

Professional marks will be awarded in part (a) for clarity and quality of discussion.

(2 marks)

- (b) (i) Discuss, with suitable calculations, the principles of how Handfood Co should account for the current service cost of its employee benefit for the year ended 31 December 20X2. (6 marks)
- (ii) Discuss the impact on the additional employee benefit for the year ended 31 December 20X3 if Handfood Co were to take into account the following changes in assumptions:
- an increase in employees' salaries above 3% per annum; and
 - a decrease in the probability of employees leaving the company.

Note: there is no need to provide any calculations in your answer to (b) (ii).

(4 marks)

(Total: 25 marks)

39 LERIA CO (MAR 2020)***Walk in the footsteps of a top tutor*****Background**

Leria Co is an internationally successful football club. Leria Co is preparing the financial statements for the year ending 31 October 20X5 but is currently facing liquidity problems.

Stadium sale/leaseback and improvements

Leria Co has entered into a contract regarding its stadium whereby it will sell the stadium on 30 November 20X6 and immediately lease it back. The directors of Leria Co wish to classify the stadium as a non-current asset 'held for sale' in its financial statements for the year ended 31 October 20X5 as they believe the sale to be highly probable at that date. The sale contract requires the disposal of the stadium for its fair value (market value) of \$30 million and for Leria Co to lease it back over 10 years. The present value of the lease payments at market rates on 30 November 20X6 will be \$26 million. The market value for a stadium of this type has not changed in several years and is unlikely to change in the near future. The stadium is being depreciated by 5% per annum using the reducing balance method.

In the year to 31 October 20X6, it is anticipated that \$2 million will be spent to improve the crowd barriers in the stadium. There is no legal requirement to improve the crowd barriers. Leria Co has incorrectly treated this amount as a reduction of the asset's carrying amount at 31 October 20X5 and the corresponding debit has been made to profit or loss. At 31 October 20X5, the carrying amount of the stadium, after depreciation and deduction of the crowd barrier improvements, is \$18 million.

Television programme content rights

Leria Co has its own subscription-based television station. As a result, it has material intangible assets which relate to the content rights associated with the television programmes. The budgeted costs of production are based on the estimated future revenues for the television programme. These costs of production are then capitalised as an intangible asset and called 'contents rights'. The directors of Leria Co believe that the intellectual property in the content rights is consumed as customers view the television programmes. Consequently, Leria Co currently amortises the content rights based upon estimated future revenues from the television programme. For example, if a television programme is expected to generate \$8 million of revenue in total and \$4 million of that revenue is generated in year 1, then the intangible asset will be amortised by 50% in year 1. However, the industry practice is to amortise the capitalised cost of the programme, less its recoverable amount, over its remaining useful life.

Players' contract costs

Players' registration contract costs are shown as intangible assets and are initially recognised at the fair value of the consideration paid for their acquisition. However, subsequently, players' contracts are often re-negotiated at a cost. Also, players' contracts may contain contingent performance conditions where individual players may be paid a bonus based on their success in terms of goals scored or the success of the football team as a whole. These bonuses represent additional contract costs.

For impairment purposes, Leria Co does not consider that it is possible to determine the value-in-use of an individual player unless the player were to suffer a career threatening injury and cannot play in the team. Players only generate direct cash flows when they are sold to another football club.

Required:

- (a) **Discuss with reference to IFRS Standards:**
- (i) whether the directors can classify the stadium as held for sale at 31 October 20X5
 - (ii) Leria Co's accounting treatment of the crowd barrier improvements at 31 October 20X5; and
 - (iii) the principles of the accounting treatment for the sale and leaseback of the stadium at 30 November 20X6. (13 marks)
- (b) **Discuss:**
- (i) whether the amortisation of the intangible assets relating to television programme content rights by Leria Co and by the industry are acceptable policies in accordance with IFRS standards; and
 - (ii) how to account for the players' contract costs (including the contingent performance conditions), any impairment which might be required to these non-current assets and whether a player can be considered a single cash generating unit. (12 marks)
- (Total: 25 marks)

40 ECOMA CO (MAR 2020)



Walk in the footsteps of a top tutor

(a) **Sustainability**

There is a global trend towards more extensive and more meaningful narrative reporting. Improvements in the quality and scope of this reporting are driven by regulatory demands as well as market demands for transparency. Many investors now adhere to 'sustainable investing', an approach to investment where environmental, social or governance (ESG) factors, in combination with financial considerations, guide the selection and management of investments.

Required:

Discuss why the disclosure of sustainable information has become an important and influential consideration for investors. (8 marks)

(b) **Background**

The directors of Ecoma Co consider environmental, social and governance issues to be extremely important in a wide range of areas, including new product development, reputation building and overall corporate strategy. The company is taking a proactive approach to managing sustainability and is actively seeking opportunities to invest in sustainable projects and embed them in their business practices. The company's financial year end is 30 September 20X5.

Head office

Ecoma Co is committed to a plan to move its head office to a building which has an energy efficient green roof that acts as a natural temperature controller. The move from the current head office, which is leased, will take place at the company's year end of 30 September 20X5. The new green roof building requires less maintenance than a conventional building and produces oxygen which offsets Ecoma Co's CO₂ emissions.

The directors of Ecoma Co believe that the green roof building will save the company \$2 million per annum over the useful life of the building. However, over the next two years, it anticipates that the disruption of the move will cause the company to make a loss of \$10 million per annum. The company wishes to make a provision of \$16 million which comprises the loss to be incurred over the next two years net of the saving created by the green roof.

Meanwhile, the company will have to vacate its currently leased head office building. At 30 September 20X5, the lease has two years to run with rentals payable in advance on 1 October each year.

The pre-tax discount rate is 5%.

Defined benefit pension scheme

Ecoma Co is worried that the poor remuneration package offered to employees is putting the company at risk of reputational damage. Consequently, Ecoma Co changed its pension scheme on 30 September 20X5 to include all of its staff. The benefits accrue from the date of their employment but only vest after two years additional service from 30 September 20X5. The net pension obligation at 30 September 20X5 of \$78 million has been updated to include this change. During the year, benefits of \$6 million were paid under the scheme and Ecoma Co contributed \$10 million to the scheme. These payments had been recorded in the financial statements but no other entries for the year have been made. The following information relates to the pension scheme:

Net pension obligation at 30 September 20X5	\$78m
Net pension obligation at 30 September 20X4	\$59m
Current service cost for year	\$18m
Past service cost relating to scheme amendment at 30 September 20X5	\$9m
Discount rate at 30 September 20X4	5.5%
Discount rate at 30 September 20X5	5.9%

Required:

- (i) In accordance with relevant IFRS Standards, discuss how the \$16 million provision associated with Ecoma Co's move to a new head office and the vacation of its old head office should be accounted for. (6 marks)
- (ii) Advise Ecoma Co on the principles of accounting for the pension scheme, including calculations, for the year to 30 September 20X5. (7 marks)
- (iii) Calculate the impact which the above adjustments in (b) (ii) will have on profit before tax of \$25 million for the year ended 30 September 20X5. Ignore potential tax implications. (2 marks)

Professional marks will be awarded in part (a) for clarity and quality of discussion. (2 marks)

(Total: 25 marks)

41 DIGIWIRE (SEP/DEC 2019)  *Walk in the footsteps of a top tutor*

Digiwire Co has developed a new business model whereby it sells music licences to other companies which then deliver digital music to consumers.

Revenue: sale of three-year licence

Digiwire Co has agreed to sell Clamusic Co, an unlisted technology start-up company, a three-year licence to sell Digiwire Co's catalogue of classical music to the public. This catalogue contains a large selection of classical music which Digiwire Co will regularly update over the three-year period.

As payment for the three-year licence, Clamusic Co has issued shares to Digiwire Co equivalent to a 7% shareholding. Voting rights are attached to these shares. Digiwire Co received the shares in Clamusic Co on 1 January 20X6, which is the first day of the licence term.

Digiwire Co will also receive a royalty of 5% of future sales of Clamusic Co as additional revenue for the licence.

Clamusic Co valuation and revenue

On 1 January 20X6, Clamusic Co was valued at between \$4–\$5 million by a professional valuer who used a market-based approach. The valuation was based on the share price of a controlling interest in a comparable listed company.

For the financial year end of 31 December 20X6, sales of the classical music were \$1 million. At 31 December 20X6, a further share valuation report had been produced by the same professional valuer which indicated that Clamusic Co was valued in the region of \$6–\$7 million.

Investment in FourDee Co

Digiwire Co has agreed to work with TechGame Co to develop a new music platform. On 31 December 20X6, the companies created a new entity, FourDee Co, with equal shareholdings and shares in profit. Digiwire Co has contributed its own intellectual property in the form of employee expertise, cryptocurrency with a carrying amount of \$3 million (fair value of \$4 million) and an office building with a carrying amount of \$6 million (fair value of \$10 million). The cryptocurrency has been recorded at cost in Digiwire Co's financial statements. TechGame Co has contributed the technology and marketing expertise. The board of FourDee Co will comprise directors appointed equally by Digiwire Co and TechGame Co. Decisions are made by a unanimous vote.

Pension plan

Digiwire Co provides a defined benefit pension plan for its employees. From 1 September 20X6, Digiwire Co decided to curtail the plan and to limit the number of participants. The monthly service cost calculated using assumptions at the start of the year is \$9 million. The monthly service cost calculated using assumptions at 1 September 20X6 is \$6 million. The relevant financial information relating to the plan is as follows:

Date	Net deficit	Discount rate
	\$m	%
1 January 20X6	30	3
1 September 20X6	36	3.5
31 December 20X6	39	3.7

Required:

- (a) Advise the directors of Digiwire Co on the recognition and measurement of the:
- (i) Clamusic Co shares received as revenue for the sale of the three-year licence and how they should be accounted for in the financial statements for the year ended 31 December 20X6; and
 - (ii) royalties which Clamusic Co has agreed to pay in respect of the three-year licence in the financial statements for the year ended 31 December 20X6. Your answer to (a) (ii) should demonstrate how recognition and measurement of the royalties is supported by the *Conceptual Framework for Financial Reporting*. (10 marks)
- (b) Based on International Financial Reporting Standards, advise the directors on the following:
- (i) the classification of the investment which Digiwire Co has in FourDee Co
 - (ii) the derecognition of the assets exchanged for the investment in FourDee Co and any resulting gain/loss on disposal in the financial statements of Digiwire Co at 31 December 20X6; and
 - (iii) whether the cryptocurrency should be classified as a financial asset or an intangible asset. Your answer should also briefly consider whether fair value movements on the cryptocurrency should be recorded in profit or loss. (10 marks)
- (c) Discuss the accounting repercussions of the pension plan curtailment, including a calculation of the net interest component and current service cost for the year ended 31 December 20X6. (5 marks)
- (Total: 25 marks)

42 GUIDANCE (SEP/DEC 2019)***Walk in the footsteps of a top tutor***

Guidance Co is considering the financial results for the year ended 31 December 20X6. The industry places great reliance on the return on equity (ROE) as an indicator of how well a company uses shareholders' funds to generate a profit.

Return on equity (ROE)

Guidance Co analyses ROE in order to understand the fundamental drivers of value creation in the company. ROE is calculated as:

$$\text{Return on equity} = \frac{\text{Net profit before tax}}{\text{Sales}} \times \frac{\text{Sales}}{\text{Assets}} \times \frac{\text{Assets}}{\text{Equity}}$$

Guidance Co uses year-end equity and assets to calculate ROE.

The following information relates to Guidance Co for the last two years:

	20X5	20X6
	\$m	\$m
Net profit before tax	30	38
Sales	200	220
Assets at 31 December	250	210
Equity at 31 December	175	100

Special purpose entity (SPE)

During the year ended 31 December 20X6, Guidance Co stated that it had reorganised its assets and set up a SPE. Guidance Co transferred property to the SPE at its carrying amount of \$50 million, but had incorrectly charged revaluation reserves with this amount rather than showing the transfer as an investment in the SPE. The property was the SPE's only asset. However, Guidance Co still managed the property, and any profit or loss relating to the assets of the entity was remitted directly to Guidance Co. Guidance Co had no intention of consolidating the SPE.

Miscellaneous transactions

Guidance Co has bought back 25 million shares of \$1 for \$1.20 per share during the year ended 31 December 20X6 for cash and cancelled the shares. This transaction was deemed to be legal.

Guidance Co purchased a 25% interest in an associate company on 1 July 20X6 for cash. The investment had cost \$15 million and the associate had made profits of \$32 million in the year to 31 December 20X6. Guidance Co accounted for the purchase of the associate correctly.

These miscellaneous transactions have been accounted for in the financial information provided for the year ended 31 December 20X6.

- (a) Management's intent and motivation will often influence accounting information. However, corporate financial statements necessarily depend on estimates and judgement. Financial statements are intended to be comparable but their analysis may not be the most accurate way to judge the performance of any particular company. This lack of comparability may be due to different accounting policy choices or deliberate manipulation.

Required:

Discuss the reasons why an entity may choose a particular accounting policy where an IFRS Standard allows an accounting policy choice and whether faithful representation and comparability are affected by such choices. (6 marks)

- (b) (i) Discuss the usefulness to investors of the ROE ratio and its component parts provided above and calculate these ratios for the years ended 31 December 20X5 and 20X6. These calculations should be based upon the information provided in table 1. (5 marks)
- (ii) Discuss the impact that the setting up of the SPE and miscellaneous transactions have had on ROE and its component parts. Given these considerations, adjust table 1 and recalculate the ROE for 20X6 thereby making it more comparable to the ROE of 20X5. (12 marks)

Professional marks will be awarded in part (b) for clarity and quality of discussion. (2 marks)

(Total: 25 marks)

43 CRYPTO (MAR/JUN 2019)

*Walk in the footsteps of a top tutor*

- (a) (i) Crypto operates in the power industry, and owns 45% of the voting shares in Kurran. Kurran has four other investors which own the remaining 55% of its voting shares and are all technology companies. The largest of these holdings is 18%. Kurran is a property developer and purchases property for its renovation potential and subsequent disposal. Crypto has no expertise in this area and is not involved in the renovation or disposal of the property.

The board of directors of Kurran makes all of the major decisions but Crypto can nominate up to four of the eight board members. Each of the remaining four board members are nominated by each of the other investors. Any major decisions require all board members to vote and for there to be a clear majority. Thus, Crypto has effectively the power of veto on any major decision. There is no shareholder agreement as to how Kurran should be operated or who will make the operating decisions for Kurran. The directors of Crypto believe that Crypto has joint control over Kurran because it is the major shareholder and holds the power of veto over major decisions.

The directors of Crypto would like advice as to whether or not they should account for Kurran under IFRS 11 *Joint Arrangements*. **(6 marks)**

- (ii) On 1 April 20X7, Crypto entered into a contract to purchase a fixed quantity of electricity at 31 December 20X8 for 20 million euros. Both Crypto and the supplier have a functional currency of dollars. The electricity will be used in Crypto's production processes.

Crypto has separated out the foreign currency embedded derivative from the electricity contract and measured it at fair value through other comprehensive income (FVTOCI). However, on 31 December 20X7, there was a contractual modification, such that the contract is now an executory contract denominated in dollars. At this date, Crypto calculated that the embedded derivative had a negative fair value of 2 million euros.

The directors of Crypto would like advice as to whether they should have separated out the foreign currency derivative and measured it at FVTOCI, and how to treat the modification in the contract. **(5 marks)**

Required:

Advise the directors of Crypto as to how the above issues should be accounted for with reference to relevant IFRS Standards.

Note: The split of the mark allocation is shown against each of the two issues above.

- (b) Previous leasing standards were heavily criticised by financial statement users. One reason for this was that lessees were often not required to recognise lease liabilities on the statement of financial position. This approach would lead to significant off-balance sheet finance. IFRS 16 *Leases* was issued in response to such criticisms and rectified the problem.

Required:

- (i) Discuss some of the key effects to the financial statements as observed by investors caused by the improved accounting treatment adopted by IFRS 16, as described above. (6 marks)
- (ii) If a company were to apply the improved accounting treatment for leases under IFRS 16 for the first time, discuss the likely impact that IFRS 16 will have generally on accounting ratios and particularly on:
 - Earnings before interest and tax to interest expense (interest cover)
 - Earnings before interest and tax to capital employed (return on capital employed)
 - Debt to earnings before interest, tax, depreciation and amortisation (EBITDA). (6 marks)

Professional marks will be awarded in this question for clarity and quality of discussion. (2 marks)

(Total: 25 marks)

44 ZEDTECH (MAR/JUN 2019)

- (a) Zedtech is a software development company, listed on a local stock exchange, which provides data hosting and other professional services. As part of these services, Zedtech also securely hosts a range of inventory management software online which allows businesses to manage inventory from anywhere in the world. It also sells hardware in certain circumstances.

Zedtech sells two distinct software packages. The first package, named Oinventory, gives the customer the option to buy the hardware, professional services and hosting services as separate and distinct contracts. Each element of the package can be purchased without affecting the performance of any other element. Zedtech regularly sells each service separately and generally does not integrate the goods and services into a single contract.

With the second package, InventoryX, the hardware is always sold along with the professional and hosting services and the customer cannot use the hardware on its own. The hardware is integral to the delivery of the hosted software. Zedtech delivers the hardware first, followed by professional services and finally, the hosting services. However, the professional services can be sold on a stand-alone basis as this is a distinct service which Zedtech can offer any customer.

Zedtech has decided to sell its services in a new region of the world which is suffering an economic downturn. The entity expects the economy to recover and feels that there is scope for significant growth in future years. Zedtech has entered into an arrangement with a customer in this region for promised consideration of \$3 million. At contract inception, Zedtech feels that it may not be able to collect the full amount from the customer and estimates that it may collect 80% of the consideration.

Required:

- (i) Discuss the principles in IFRS 15 *Revenue from Contracts with Customers* which should be used by Zedtech to determine the recognition of the above contracts. (5 marks)
- (ii) Discuss how the above contracts should be recognised in the financial statements of Zedtech under IFRS 15. (7 marks)

The directors of Zedtech have heard through industry forums and think-tanks that sustainability reporting is becoming a primary focus for the executives within Zedtech's industry. Zedtech's management are keen to promote the ways that Zedtech positions sustainability at the core of its operations.

- (b) Discuss the specific factors that Zedtech must consider to ensure they operate in a sustainable fashion and how sustainability reporting could be important to Zedtech's management and stakeholders. (8 marks)

Zedtech has a reporting date of 31 December 20X1. On the reporting date, it enters into a 5-year lease agreement to hire a new server to improve software performance and deal with increased data storage requirements. The present value of the lease payments to be made is \$15 million. Lease rentals are paid in advance and the first \$4m has already been paid. In Zedtech's tax jurisdiction, tax relief on leases is given in respect of the lease liability as payments are made. The tax rate is 20%.

- (c) Explain the deferred tax implications caused by the lease arrangement entered into by Zedtech. (5 marks)

(Total: 25 marks)

45 FILL (DEC 2018)

- (a) Fill is a coal mining company and sells its coal on the spot and futures markets. On the spot market, the commodity is traded for immediate delivery and, on the forward market, the commodity is traded for future delivery. The inventory is divided into different grades of coal. One of the categories included in inventories at 30 November 20X6 is coal with a low carbon content which is of a low quality. Fill will not process this low quality coal until all of the other coal has been extracted from the mine, which is likely to be in three years' time. Based on market information, Fill has calculated that the three-year forecast price of coal will be 20% lower than the current spot price.

The directors of Fill would like advice on two matters:

- (i) whether the *Conceptual Framework* affects the valuation of inventories
 - (ii) how to calculate the net realisable value of the coal inventory, including the low quality coal. (7 marks)
- (b) At 30 November 20X6, the directors of Fill estimate that a piece of mining equipment needs to be reconditioned every two years. They estimate that these costs will amount to \$2 million for parts and \$1 million for the labour cost of their own employees. The directors are proposing to create a provision for the next reconditioning which is due in two years' time in 20X8, along with essential maintenance costs. There is no legal obligation to maintain the mining equipment.

As explained above, it is expected that there will be future reductions in the selling prices of coal which will affect the forward contracts being signed over the next two years by Fill.