

---

# Answers

---

1 Consolidated statement of financial position of Alpha as at 30 September 20X2

		\$000
<b>Assets</b>		
<b>Non-current assets</b>		
Property, plant and equipment	(680,000 + 430,000 + 20,000 (W1) – 8,000 (W1))	1,122,000
Intangible assets	(3,000 + 1,600 (W1) – 800 (W1) + 2,484 (W8) – 497 (W8))	5,787
Investment in associate	(W5)	20,250
Goodwill	(W2)	49,760
		<u>1,197,797</u>
<b>Current assets</b>		
Inventories	(30,000 + 28,000 – 625 (W6))	57,375
Trade receivables	(16,700 + 9,800)	26,500
Cash and cash equivalents	(12,000 + 6,450)	18,450
		<u>102,325</u>
Total assets		<u>1,300,122</u>
<b>Equity and liabilities</b>		
<b>Equity</b>		
Share capital (\$1 shares)		380,000
Retained earnings	(W4)	720,505
Non-controlling interest	(W3)	103,500
Total equity		<u>1,204,005</u>
<b>Non-current liabilities</b>		
Provision	(2,484 (W8) + 248 (W8))	2,732
Long-term borrowings	(4,200 + 8,900)	13,100
Deferred tax	(3,750 + 4,500 + 2560 (W1) – 125 (W6))	10,685
Total non-current liabilities		<u>26,517</u>
<b>Current liabilities</b>		
Trade and other payables	(18,960 + 11,400)	30,360
Short-term borrowings	(29,790 + 9,450)	39,240
Total current liabilities		<u>69,600</u>
Total equity and liabilities		<u>1,300,122</u>

**Workings**

**W1 Net assets – Beta**

	Acquisition \$000	Year end \$000	Movement \$000
Share capital	100,000	100,000	
Retained earnings	275,000	340,000	
FV adjustment: PPE	20,000	20,000	
FV depreciation (\$20 million/5 years x 2)		(8,000)	
Contingent liability	(4,000)	nil	
Customer list	1,600	1,600	
Amortisation of customer list (\$1.6m/4 years x 2)		(800)	
Deferred tax on fair value adjustment	(3,520)	(2,560)	
Net assets for consolidation	<u>389,080</u>	<u>450,240</u>	61,160
Post-acquisition increase in net assets (\$450,240 – \$389,080)			

<b>W2 Goodwill – Beta</b>			<b>\$000</b>
Cost of investment			380,000
NCl at acquisition			98,000
			<u>478,000</u>
Less net assets (W1)			(389,080)
Goodwill at acquisition			88,920
Less impairment (W7)			(39,160)
Goodwill at 30 September 20X2			<u>49,760</u>
<b>W3 Non-controlling interest in Beta</b>			<b>\$000</b>
At acquisition (W2)			98,000
NCl share of movement (25% x \$61,160 (W1))			15,290
Impairment (25% x \$39,160 (W7))			(9,790)
			<u>103,500</u>
<b>W4 Retained earnings</b>			<b>\$000</b>
Alpha			703,000
Alpha % of Beta post-acquisition profits (75% x \$61,160 (W1))			45,870
Alpha % of associate (Drax) post acquisition (W5)			2,250
PURP (W6)			(500)
Impairment (75% x \$39,160) (W7)			(29,370)
Adjustments re provision (W8)			(745)
			<u>720,505</u>
<b>W5 Investment in associate (Delta)</b>			<b>\$000</b>
Cost			18,000
25% of post-acquisition profits (\$79,000 – \$70,000 (W4))			2,250
Carrying amount at 30 September 20X2			<u>20,250</u>
<b>W6 PURP</b>			<b>\$000</b>
Sales in inventory (\$15m x 25%)			3,750
Unrealised profit (\$3,750 x 20/120)			625
Deferred tax asset (\$625 x 20%)			125
Adjustment to retained earnings			<u>500</u>
<b>W7 Impairment of Beta as at 30 September 20X2</b>			<b>\$000</b>
Net assets of Beta			450,240
Goodwill on acquisition			88,920
			<u>539,160</u>
Recoverable amount of Beta as a CGU			500,000
Impairment			<u>39,160</u>
<b>W8 Adjustment re provision:</b>			<b>\$000</b>
Provision recognised on 1 October 20X1	(4,000 x 0.621)		2,484
Unwind discount on 30 September 20X2	(2,484 x 0.1)		248
			<u>2,732</u>
Amortisation at 30 September 20X2	(2,484/5)		497
Retained earnings adjustment (W4)	(248 + 497)		745

## 2 Attachment 1 to email

The relevant standard is IFRS 15 – *Revenue from Contracts with Customers*. Under IFRS 15, the sale of goods with an after-sales service must be considered as two separate performance obligations (principle).

Where the transaction price is a single amount, then it needs to be allocated to the individual performance obligations based on the relative stand-alone selling prices of the individual components (principle).

In this case, the sum of the selling prices of the individual components is \$960,000 [\$800,000 (the stand-alone selling price of the machine) + 2 x \$80,000 (the stand-alone selling price of a two-year repair contract)].

Given that the agreed price payable for the 'bundle' is \$840,000, then the revenue from the sale of the machine would be measured at **\$700,000** (\$840,000 x 800,000/960,000). This would be recognised in **full** in the year ended 30 September 20X5 as delivery of the machine means the performance obligation has been satisfied.

Therefore the revenue from the after-sales repair service would be **\$140,000** (\$840,000 – \$700,000). This revenue needs to be recognised over the two-year period from 1 April 20X5 – the period in which Gamma provides the service to the customer (principle).

This means that the revenue recognised from this source in the year ended 30 September 20X5 is \$35,000 (140,000 x 6/24).

The difference of \$105,000 between the amount received from the customer (\$840,000) and the amount recognised as revenue in the year ended 30 September 20X5 (\$700,000 + \$35,000 = \$735,000) will be shown as a contract liability (deferred income) in the statement of financial position of Gamma.

The contract liability will be split between current and non-current (principle). **\$70,000** (\$105,000 x 12/18) will be shown as a current liability and **\$35,000** as a non-current liability.

IFRS 15 requires that the costs of fulfilling a contract (the repair service) should initially be recognised as assets and taken to profit or loss on a systematic basis as goods or services are transferred to the customer (principle).

In this case, it would appear that the costs incurred to date (\$20,000) of fulfilling the repair service should be shown as a cost in profit or loss rather than as an asset in the statement of financial position (principle).

Given that the total costs of fulfilling the contract are estimated to be \$50,000 per annum, there is a case for arguing that \$25,000 (50,000 x 6/12) should be recognised in profit or loss (not just the \$20,000 incurred) as a cost in the year ended 30 September 20X5 with a liability of \$5,000 (25,000 – 20,000) recognised in current liabilities.

### W1 – Spreadsheet workings: computation of revenue recognised

	Machine \$	Repair service \$	Total \$
Stand-alone selling price	800,000	160,000	960,000
'Bundle' price			840,000
Allocation of 'bundle price' in relevant proportions	700,000	140,000	840,000
Revenue recognised in the period	700,000	35,000	735,000
Amount received from customer in the period	(700,000)	(140,000)	(840,000)
So contract liability at year end equals	n/a	(105,000)	(105,000)
Settled within 12 months (12/18)	n/a	70,000	70,000
Settled after more than 12 months (6/18)	n/a	35,000	35,000

## Attachment 2 to email

The relevant standard is **IAS 36 – Impairment of Assets**. IAS 36 requires that assets are reviewed for impairment whenever indicators of impairment are present (principle). The fact that there is currently a surplus of properties available for rental is *prima-facie* evidence that indicators are present in this case (principle).

An impairment review involves comparing the carrying amount of an asset with its recoverable amount. The recoverable amount of an asset is the higher of its value in use and its fair value less costs of disposal (principle).

The value in use of the asset in this case is **\$1 million**. IAS 36 requires that value in use be computed based on the existing use to which the asset is being put, with no account taken of potential changes in use due to possible future restructurings (principle). The fair value less costs of disposal is \$900,000 which is lower than the value in use.

Therefore the property has suffered impairment of **\$200,000** (\$1.2 million – \$1 million). This amount will be taken to **profit or loss** as an operating cost.

The revised carrying amount of the asset will be \$1 million. This will be shown as a non-current asset in the statement of financial position.

## W2 – Spreadsheet workings: calculation of earnings per share

	\$
Earnings as per draft financial statements (exhibit 1)	1,800,000
Adjustments to revenue and for repair service costs (\$105,000 + \$20,000 – OF rule applies here. Adjustment of \$20,000 could alternatively have been \$25,000)	<u>(125,000)</u>
Impairment of property	<u>(200,000)</u>
Earnings as corrected	<u>1,475,000</u>
Weighted average number of shares = $4,500,000 \times 4/12 + 6,000,000 \times 8/12$	<u>5,500,000</u>
Therefore earnings per share equals $(1,475,000/5,500,000)$	<u>26.8 cents</u>

### Ethical issue – Email from FD

You are in danger of breaching the fundamental ethical principle of objectivity. You have a personal interest in reporting a favourable profit because of the fact that you own shares in Gamma and a favourable profit could result in enhanced dividends and shareholder value.

You face a further danger of breaching the principle of objectivity because of the way the FD has linked your complying with this instructions to your upcoming staff appraisal (candidates who refer to an intimidation threat here will receive appropriate credit).

You also may be breaching the fundamental ethical principle of professional competence and due care. The treatments suggested by the FD are clearly inappropriate and not in compliance with IFRS standards. Were you to implement them, you would be in breach of your professional duty to conduct yourself in a competent manner.

### 3 (a) Exhibit 1 – Purchase of assets

IAS 38 – *Intangible Assets* states that intangible assets can only be recognised if it is probable that economic benefits attributable to the asset will flow to the entity and the cost of the asset can be measured reliably (principle).

In the case of the purchase of the brand name, both of these conditions are satisfied (conclusion).

IAS 38 states that intangible assets should be amortised **over their useful lives** where the useful life is considered to be **finite** (principle).

Where the useful life of an intangible asset is considered to be indefinite, then the asset should not be amortised and the useful life would be reviewed annually. Additionally, the brand should be reviewed annually for impairment, regardless of whether indicators of impairment are present (principle).

Based on the information provided, it would appear that **no impairment** is necessary and the asset can be shown at a carrying amount of **\$60 million**. \$60 million would be shown as a **non-current asset**.

**\$18 million** would be recognised in **revenue** for the inventories sold during the year ended 30 September 20X5.

In the same period, **\$15 million** ( $\$20 \text{ million} \times 75\%$ ) would be recognised in **cost of sales**. Both the \$18 million and the \$15 million would be included in the statement of **profit or loss** for the year ended 30 September 20X5.

Under the principles of **IAS 10 – Events After the Reporting Date** – the post year-end date sale of goods held in inventory at the year end is an **adjusting event**.

The goods held in inventory have a cost of **\$5 million** ( $\$20 \text{ million} - \$15 \text{ million}$ ) but were sold for \$4.5 million. \$4.5 million is therefore their **net realisable value**.

Under the principles of IAS 2, inventories are measured at the **lower of cost and net realisable value**. Therefore inventories of **\$4.5 million** would be recognised as a **current asset**.

The required write down of **\$0.5 million** ( $\$5 \text{ million} - \$4.5 \text{ million}$ ) would be recognised in the statement of **profit or loss** for the year ended 30 September 20X5.

### Exhibit 2 – Interest free loans to employees

Under the principles of IFRS 9 – *Financial Instruments* – the loans are a **financial asset** of Delta. IFRS 9 states that financial assets should initially be recognised at fair value in the financial statements (**principle**).

In this case, the initially recognised amount will be \$10 million [ $\$12 \cdot 10 / (1 \cdot 10)^2$ ].

The difference of \$2.1 million between the amount lent and the financial asset will be regarded as an employee benefit under IAS 19 *Employee Benefits*, and recognised as an expense over the two-year period from 1 October 20X4 to 30 September 20X6 (principle).

Therefore, in the year ended 30 September 20X5, an employment expense of **\$1.05 million** ( $2 \cdot 10 / 2$ ) would be recognised in the statement of **profit or loss**.

The residual difference of **\$1.05 million** (\$2.1 million – \$1.05 million) would be recognised as a deferred employee compensation **prepayment** in the statement of financial position at 30 September 20X5. The prepayment will be shown as a **current asset**.

Since the cash flows expected from the loan asset are known in terms of their timing and amount and Delta expects to retain the asset and collect the cash flows as they fall due, the loan asset can be measured at amortised cost from 1 October 20X4 (principle – up to).

This means that Delta will recognise finance income of **\$1 million** (\$10 million x 10%) in its statement of **profit or loss** for the year ended 30 September 20X5.

The loan asset at 30 September 20X5 will be **\$11 million** (\$10 million + \$1 million). This will be shown as a **current asset** in the statement of financial position of Delta.

**Tutorial note:** *Candidates who recognise the employment cost on an 'amortised cost' basis, i.e. \$1 million (\$10 million x 10%) in the year ended 30 September 20X5 and \$1.1 million (\$11 million x 10%) in the year ended 30 September 20X6 will receive full credit.*

#### (b) Exhibit 3 – Manufacturing process

IAS 38 does not allow any expenditure on a research and development project to be recognised as an asset until the technical feasibility and commercial viability of the project has been established (principle).

After the technical feasibility and commercial viability of the project has been established, expenditure which has previously been shown as an expense in profit or loss cannot be restated as an intangible asset (principle).

This means that, for the year ended 30 September 20X4, the on-going project costs of **\$9 million** (9 x \$1 million) will have been expensed in the statement of **profit or loss** and the further **\$3 million** from 1 October to 31 December 20X4 will be expensed in the profit or loss for the year ending 30 September 20X5.

Under the principles of IAS 16 – *Property, Plant and Equipment* (PPE) – the machinery purchased on 1 January 20X4 will be regarded as PPE and depreciated over its useful life of 18 months (from 1 January 20X4 to 30 June 20X5).

The depreciable amount will be its cost less its estimated residual value (**principle**). In this case, the depreciable amount is **\$13.5 million** (\$15 million – \$1.5 million). Therefore the monthly depreciation will be **\$750,000** (\$13.5 million/18).

The depreciation of **\$6.75 million** (9 x \$750,000) for the nine months from 1 January 20X4 to 30 September 20X4 and \$2.25 million (3 x \$750,000) for the three months from 1 October to 20X4 to 31 December 20X4 will be shown as an **expense** in the statements of profit or loss for 20X4 and 20X5 respectively.

From 1 January 20X5, ongoing expenditure on the project will be able to be recognised as an intangible asset by Delta. This applies to both the on-going project costs and the depreciation of the machinery exclusively used on the project (**principle**).

Therefore at 30 June 20X5 (the date the project is concluded), the intangible asset will be \$16.5 million (6 x \$2 million + 6 x \$750,000).

IAS 38 requires that intangible assets with finite useful lives be amortised over those lives (principle already rewarded). Amortisation starts from the date the asset is **available for use**, rather than the date it is actually brought into use. In this case, that date is **30 June 20X5**.

Therefore amortisation for the year ended 30 September 20X5 will be **\$825,000** (\$16.5 million x 1/5 x 3/12).

The closing carrying amount of the intangible asset will be **\$15,675,000** (\$16.5 million – \$825,000). This will be shown as a **non-current asset** in the statement of financial position of Delta at 30 September 20X5.

On 30 June 20X5, the carrying amount of the machinery will be **\$1.5 million**. **No further depreciation will be charged** because the machinery is being advertised for sale from that date.

A profit on sale of the machinery of **\$300,000** (\$1.8 million – \$1.5 million) will be shown in the statement of **profit or loss** of Delta for the year ended 30 September 20X5.

#### 4 Exhibit 1 – Assets of subsidiary

**IAS 41 Agriculture** deals with **agricultural activity**. Agricultural activity is the management by an entity of biological transformation and harvest of biological assets for sale or conversion into agricultural produce or into additional biological assets.

A biological asset is a living plant or animal. Cattle or sheep are examples of biological assets.

Agricultural produce is the harvested produce of biological assets. Both milk and meat are examples of agricultural produce.

Therefore IAS 41 applies to many of the assets of our farming subsidiary (conclusion).

IAS 41 states that biological assets should normally be measured at fair value less costs to sell in the statement of financial position on initial recognition and at each year end.

Where cattle or sheep are purchased at a market, this means a reliable fair value and related costs can be used to arrive at initial recognised costs and any subsequent increase/decrease at the year end.

In the case of newly born cattle or sheep, the same 'fair value less costs to sell' principle applies.

A gain or loss arising on initial recognition or arising from a change in fair value less costs to sell at the year end are included in profit or loss.

This means that there is immediate recognition of a gain (equal to fair value less costs to sell) in profit or loss as the relevant biological asset is recognised when cattle and sheep are newly born.

IAS 41 does allow the 'cost model' to be used for biological assets if fair values cannot be measured reliably but this is unlikely to be true for biological assets like cattle or sheep where market values are available.

IAS 41 states that agricultural produce should be measured at its fair value less costs to sell at the point of harvest (principle).

IAS 41 defines 'harvesting' as the detachment of produce from a biological asset (for example, the milking of a cow) or the cessation of a biological asset's life processes (for example, the slaughter of a cow or a sheep for its meat).

The initial recognition of agricultural produce in the statement of financial position is likely to lead to an equal gain being recognised in the statement of profit or loss.

From this point on, agricultural produce would be subject to the recognition and measurement requirements of IAS 2 – *Inventories*.

Profits or losses on the subsequent sale of agricultural produce would be recognised when such produce was actually sold.

Other assets of our farming subsidiary (for example, farmland, farm machinery or trade receivables) would be measured using the IFRS standards relevant to their nature.

## Exhibit 2 – Post year end

There is an IFRS standard, **IAS 10 *Events after the Reporting Period*** which deals with this issue. IAS 10 defines an event after the reporting date as one occurring between the reporting date and the date the financial statements are authorised for issue.

IAS 10 further classifies events after the reporting date into adjusting and non-adjusting events (principle).

An adjusting event is one which provides **additional evidence of conditions existing at the reporting date**. The first event you have queried is **an example of an adjusting event because** it provides confirmation of the amount of a liability which existed at the reporting date (since the unfair dismissal occurred on 31 December 20X4, prior to the year end).

IAS 10 requires that the impact of adjusting events be recognised in the financial statements (principle). This means **that we should recognise a liability of \$560,000 in the statement of financial position at 30 September 20X5 in respect of this case** and an expense of \$560,000 in the statement of profit or loss for the year. We should also make **additional disclosures** if this would assist the users of the financial statements.

Non-adjusting events are those events and transactions which provide additional evidence of conditions which arose **after** the reporting date. The fire at the factory is an example of a non-adjusting event.

Non-adjusting events should not be recognised in the financial statements, but should be fully disclosed in the notes to the financial statements if material.

The only exception to the 'non-recognition' rule mentioned above is if the event would be likely to impact on the going concern status of the reporting entity. This exception does not apply here because the subsidiary has the resources to finance the cost of rectifying the fire damage.

The third event you mentioned is **not an 'event after the reporting date' in accordance with IAS 10** as far as our latest financial statements are concerned because it occurred after the financial statements had been authorised for issue. The impact of this event will be shown in the **financial statements for the year ended 30 September 20X6**.

## Exhibit 3 – Purchase of inventory from a foreign supplier

This purchase is dominated in another currency and so is a foreign currency transaction. The accounting treatment for such transactions is set out in IAS 21 *The Effects of Changes in Foreign Exchange Rates*.

IAS 21 states that foreign currency transactions should initially be recorded at the rate of exchange in force when the transaction occurred (**principle**). This means that, in this case, an **inventory and a payable of \$140,000** (840,000/6) would be recorded.

The payable is settled on 31 August 20X5. The cash required to settle the payable would have been \$120,000 (840,000/7).

This means that an exchange gain of **\$20,000** (140,000 – 120,000) would be recognised in the **statement of profit or loss**.

The closing balance of inventory would have a cost of **\$140,000**. This is **because** the inventory measured at cost is a non-monetary item (i.e. it is not expressed in terms of a monetary amount receivable or payable) and is not retranslated at the year end.

IAS 2 – *Inventories* – requires that inventories be measured at the lower of cost and net realisable value (NRV) (principle).

The NRV of the inventory is **\$125,000** (\$1 million/8). The closing exchange rate of 8 is used because NRV is a **monetary** measure.

Therefore the closing inventory will be \$125,000 and a loss of \$15,000 (\$140,000 – \$125,000) will be recognised in the statement of profit or loss for the year ended 30 September 20X5.

	<i>Marks</i>
<b>1 Non-current assets</b>	
– PPE	1.5
– Intangible assets	2
– Investment in associate	1.5
– Goodwill	6
	<u>11</u>
<b>Current assets</b>	<u>2</u>
<b>Equity</b>	
– Share capital	0.5
– Retained earnings	5
– Non-controlling interests	1.5
	<u>7</u>
<b>Non-current liabilities</b>	
– Provision	2
– Other	2
	<u>4</u>
<b>Current liabilities</b>	<u>1</u>
	<u><b>25</b></u>
<b>2 Attachment 1</b>	
– Explanations per IFRS 15	7
– Calculations	5
	<u>12</u>
<b>Attachment 2</b>	
– Explanations per IAS 36	3.5
– Calculations	1.5
	<u>5</u>
<b>EPS calculations</b>	<u>3</u>
<b>Ethics</b>	<u>5</u>
	<u><b>25</b></u>



	<i>Marks</i>
<b>3 Exhibit 1</b>	
– Explanations per IAS 38	4
– Explanations per IAS 10	1
– Explanations per IAS 2	2
– Calculations	<u>2</u>
	<b>9</b>
 <b>Exhibit 2</b>	
– Explanations per IFRS 9	4
– Calculations	<u>3</u>
	<b>7</b>
 <b>Exhibit 3</b>	
– Explanations per IAS 38	3
– Calculations per IAS 38	2
– Explanations per IAS 16	2
– Calculations per IAS 16	<u>2</u>
	<b>9</b>
	<b><u>25</u></b>
 <b>4 Exhibit 1</b>	
– Explanations per IAS 41	10
– Explanations per IAS 2	<u>2</u>
	<b>12</b>
 <b>Exhibit 2</b>	
– Explanations per IAS 10	7
– Calculations	<u>1</u>
	<b>8</b>
 <b>Exhibit 3</b>	
– Explanations per IAS 21	2
– Calculations	1
– Explanations per IAS 2	1
– Calculations	<u>1</u>
	<b>5</b>
	<b><u>25</u></b>