Answers

Marks

1 Consolidated statement of financial position of Alpha at 30 September 2017

	$'000	Marks
Assets		
Non-current assets:		
Property, plant and equipment (610,000 + 310,000 + 160,000) + [60,000 – 6,500] (W1))	1,133,500	½ + ½
Goodwill (W3)	88,711	9½ (W3)
Brand name (W1)	20,000	½
Investments	13,800	½
	1,256,011	
Current assets:		
Inventories (140,000 + 85,000 + 66,000)	291,000	½
Trade receivables (95,000 + 70,000 + 59,000 – 8,000 (intra-group))	216,000	½ + ½
Cash and cash equivalents (16,000 + 13,000 + 11,000 + 8,000 (cash in transit))	48,000	½ + ½
	555,000	
Total assets	1,811,011	
Equity and liabilities		
Equity attributable to equity holders of the parent		
Share capital	240,000	½
Retained earnings (W5)	603,280	16 (W5)
Other components of equity (W8)	219,068	2½ (W8)
	1,062,348	
Non-controlling interest (W4)	126,920	2 (W4)
Total equity	1,189,268	
Non-current liabilities:		
Long-term borrowings (W9)	219,191	2 (W9)
Deferred consideration (W10)	51,852	1 (W10)
Deferred tax (W11)	146,700	1 (W11)
Total non-current liabilities	417,743	
Current liabilities:		
Trade and other payables (60,000 + 52,000 + 32,000)	144,000	½
Short-term borrowings (20,000 + 30,000 + 10,000)	60,000	½
Total current liabilities	204,000	**40**
Total equity and liabilities	1,811,011	

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

Working 1 – Net assets table – Beta

	1 October 2012 $'000	30 September 2017 $'000	For W3	For W5
Share capital	120,000	120,000	½	
Retained earnings:				
Per accounts of Beta	60,000	168,000	½	½
Fair value adjustments:				
Property (210,000 – 150,000)	60,000	60,000	½	½
Extra depreciation due to buildings uplift ((144,000 – 105,000) x 5/30)		(6,500)		½
Plant and equipment (145,000 – 122,000)	23,000	Nil	½	½
Brand	25,000	25,000	½	½
Extra amortisation due to brand uplift (25,000 x 5/25)		(5,000)		½
Deferred tax on fair value adjustments:				
Date of acquisition (20% x 108,000 (see above))	(21,600)		½	
Year end (20% x 73,500 (see above))		(14,700)		½
Net assets for the consolidation	266,400	346,800		
The post-acquisition increase in net assets is 80,400 (346,000 – 266,400).				½
			3	4
			⇒W3	⇒W5

Working 2 – Net assets table – Gamma

	1 October 2016 $'000	30 September 2017 $'000	For W3	For W5
Share capital	100,000	100,000	½	
Retained earnings:	50,000	59,000	½	½
Inventory adjustment	3,000	Nil	½	½
Deferred tax on inventory value adjustment:				
Date of acquisition (20% x 3,000 (see above))	(600)		½	
Year end (20% x nil (see above))		Nil		½
Net assets for the consolidation	152,400	159,000		
The post-acquisition increase in net assets is 6,600 (159,000 – 152,400)				½
			2	2
			⇒W3	⇒W5

Working 3 – Goodwill on consolidation

	Beta $'000	Gamma $'000	
Costs of investment:			
Shares issued to acquire Beta (90,000 x 2/3 x $3·90)	234,000		1
Cash paid to acquire shares in Gamma		120,000	½
Deferred consideration re: Gamma acquisition (56,000/(1·08)^2)		48,011	1
Non-controlling interests at date of acquisition:			
Beta – 30,000 x $2·35	70,500		½ + ½
Gamma – 20,000 x $1·75		35,000	½ + ½
Net assets at date of acquisition (W1/W2)	(266,400)	(152,400)	3 (W1) + 2 (W2))
	38,100	50,611	9½

The total goodwill is 88,711 (38,100 + 50,611)

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Working 4 – Non-controlling interests			
	Beta	**Gamma**	
	$'000	**$'000**	
At date of acquisition (W3)	70,500	35,000	½ + ½
Share of post-acquisition increase in net assets per workings 1 and 2:			
Beta – 25% x 80,400 (W1)	20,100		½
Gamma – 20% x 6,600 (W2)		1,320	½
	90,600	36,320	
			2

The total NCI is 126,920 (90,600 + 36,320)

Working 5 – Retained earnings

	$'000	
Alpha	550,700	½
Adjustment for acquisition costs:		
Gamma	(1,200)	½
Finance cost on deferred consideration (8% x 48,011 (W3))	(3,841)	1
Alpha revaluation of FVTPL investments (13,800 – 13,000)	800	1
Additional charge for share-based payment (W6)	(8,000)	2½ (W6)
Additional finance cost on convertible loan (W7)	(759)	3 (W7)
Beta (75% x 80,400 (W1))	60,300	½ + 4 (W1)
Gamma (80% x 6,600 (W2))	5,280	½ + 2 (W2)
	603,280	15½

Working 6 – Additional charge for share-based payment

	$'000	
Closing cumulative charge required $(190 x 100,000 x $1·20 x 2/3)	15,200	½ + ½ + ½
Opening amount already taken to other components of equity $(180 x 100,000 x $1·20 x 1/3)	(7,200)	½ + ½
So additional charge required is	8,000	2½
		⇒ W5

Working 7 – Convertible loan

	$'000	
Loan element		
Present value of interest stream (60,000 x 6% x 6·42)	23,112	1
Present value of repayment amount (60,000 x 0·422)	25,320	1
So loan component is	48,432	
Annual finance cost at 9% is	4,359	½
Finance cost charged in draft financial statements of Alpha (60,000 x 6%)	(3,600)	½
So adjustment equals	759	3
		⇒ W5

Working 8 – Other components of equity

	$'000	
Alpha – per own financial statements	202,000	½
Cost of shares issued to acquire Beta	(2,500)	½
Adjustment caused by share-based payment (W6)	8,000	½
Equity component of convertible loan (60,000 – 48,432 (W7))	11,568	1
	219,068	2½

Working 9 – Long-term borrowings

	$'000	
Alpha + Beta + Gamma	230,000	½
Remove incorrect carrying value of convertible	(60,000)	½
Add correct carrying value of convertible (48,432 + 759 (W7))	49,191	½ + ½
	219,191	2

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Working 10 – Deferred consideration

	$'000	
At date of acquisition (W3)	48,011	½
Finance cost to 30 September 2017 (W5)	3,841	½
	51,852	1

Working 11 – Deferred tax

	$'000	
Alpha + Beta + Gamma	132,000	½
On fair value adjustments in Beta (W1)	14,700	½
	146,700	1

2 (a) All numbers in $'000 unless otherwise stated

On 30 September 2017, Delta will report a **net pension liability** in the statement of financial position. The amount of the liability will be **12,000** (68,000 – 56,000). ½ + ½

For the year ended 30 September 2017, Delta will report the current service cost as an **operating cost** in the statement of profit or loss. The amount reported will be **6,200**. The **same treatment applies** to the past service cost of 1,500. ½ + ½ + ½

For the year ended 30 September 2017, Delta will report a **finance cost** in profit or loss based on the net pension liability at the start of the year of **8,000** (60,000 – 52,000). The amount of the finance cost will be **400** (8,000 x 5%). ½ + ½+ ½

The redundancy programme represents the partial **settlement of the curtailment of** a defined benefit obligation. **The gain on settlement of 500** (8,000 – 7,500) will be reported in the statement of profit or loss. ½ + ½

Other movements in the net pension liability will be reported as **remeasurement gains or losses** in **other comprehensive income**. ½ + ½

For the year ended 30 September 2017, the remeasurement loss will be 3,400 (working). 5

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(b) The facility is depreciated from the date it **is ready for use**, rather than when it actually starts being used. In this case, then, the facility is depreciated from **1 April 2017**. ½ + ½

Although Delta has no legal obligation to restore the piece of land, it does have a **constructive obligation**, based on its **past practice and policies**. ½ + ½

The amount of the obligation will be **1,420**, being the **present value** of the anticipated future restoration expenditure (10,000 x 0·142). ½ + ½

This will be recognised as a **provision** under **non-current liabilities** in the statement of financial position of Delta at 30 September 2017. ½ + ½

As time passes the discounted amount **unwinds**. The unwinding of the discount for the year ended 30 September 2017 will be 35·5 (1,420 x **5%** x **6/12**). ½ + ½ + ½

The unwinding of the discount will be shown as a **finance cost** in the statement of profit or loss and the closing provision will be **1,455·5** (1,420 + 35·5). ½ + ½

The initial amount of the provision is **included in the carrying amount** of the non-current asset, which becomes **21,420** (20,000 + 1,420). ½ + ½

The depreciation charge in profit or loss for the year ended 30 September 2017 is 267·75 (**21,420** x 1/40 x **6/12**). ½ + ½

The closing balance included in non-current assets will be **21,152·25** (21,420 – 267·75). ½

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Working for part (a) – remeasurement gain or loss

	$'000	
Liability at the start of the year (60,000 – 52,000)	8,000	½
Current service cost	6,200	½
Past service cost	1,500	½
Net finance cost	400	½
Gain on settlement	(500)	½
Contributions to plan	(7,000)	½
Benefits cancel out		½
Remeasurement **loss (balancing figure)**	**3,400**	½ + ½
Liability at the end of the year (68,000 – 56,000)	12,000	½
		5

3 (a) (i) IAS 17 – the previous financial reporting standard dealing with leasing – distinguished between two types of lease: finance and operating. ½

IAS 17 required lessees to recognise rights and obligations under leasing arrangements in the case of finance leases but not in the case of operating leases. 1

The distinction between finance leases and operating leases in IAS 17 was very subjective. ½

Generally speaking, classifying leases as operating leases led to financial statements of lessees reporting a more favourable picture than classifying leases as finance leases. 1

This incentive to treat leases as operating leases, together with the subjective nature of lease classification, meant that the requirements in IAS 17 needed amending. 1

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(ii) IFRS 16 requires lessees to recognise a right of use asset and an associated liability at the inception of the lease. 1

The initial measurement of the right of use asset and the lease liability will be the present value of the minimum lease payments. 1

The discount rate used to measure the present value of the minimum lease payments is the rate of interest implicit in the lease – essentially the rate of return earned by the lessor on the leased asset. [**NB:** If this rate is not available to the lessee, then a commercial rate of interest can be used instead.] ½

The right of use asset is subsequently depreciated in accordance with IAS 16 – *Property, Plant and Equipment* (assuming it is a tangible asset). ½

The lease liability is effectively treated as a financial liability which is measured at amortised cost, using the rate of interest implicit in the lease as the effective interest rate. 1

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(iii) **A short-term lease** is a lease which, at the date of commencement, has a term of 12 months or less. Lessees can **elect to treat short-term leases by recognising the lease rentals as an expense over the lease term rather than recognising a 'right of use asset' and a lease liability**. 1 + 1

A similar election – *on a lease-by-lease basis* – can be made in respect of 'low value assets'. 1

Examples of low-value underlying assets can include tablet and personal computers, small items of office furniture and telephones. (**Note:** *Any reasonable attempt to describe a 'low-value' asset would receive credit.*) 1

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(b) The initial right of use asset and lease liability would be $3,072,500 (500,000 x 6·145). 1

The initial direct costs of the lessee would be added to the right of use asset to give an initial carrying amount of $3,132,500 ($3,072,500 + $60,000). 1

Depreciation would be charged over a ten-year period, so the charge for the year ended 30 September 2017 would be $313,250 ($3,132,500 x 1/10). 1

The closing carrying amount of PPE in non-current assets would be $2,819,250 ($3,132,500 x 9/10). 1

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Kappa would recognise a finance cost in profit or loss of $307,250 ($3,072,500 x 10%).	1
The closing lease liability would be $2,879,750 ($3,072,500 + $307,250 – $500,000).	1
Next year's finance cost will be **$287,975** ($2,879,750 x 10%), so the current liability at 30 September 2017 will be $**212,025** ($500,000 – $287,975).	½ + 1
The balance of the liability of $2,667,725 ($2,879,750 – $212,025) will be non-current.	½
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4 Query One

The accounting treatment of equity investments which we do not control or significantly influence is dealt with in IFRS 9 – *Financial Instruments*.	½
Under IFRS 9, equity investments are **financial assets** which fail the '**contractual cash flow test**'. Equity investments must be measured at **fair value**.	½ + ½
Under IFRS 9, gains or losses on the remeasurement of financial assets measured at fair value are normally taken to profit or loss.	½
In the case of equity investments **not held for trading**, it is possible to make an **irrevocable election at initial recognition** to recognise gains or losses on the remeasurement to fair value in **other comprehensive income**.	½+ ½+ ½
The IASB *Conceptual Framework for Financial Reporting* makes no clear conceptual distinction between gains and losses reported in profit or loss and gains and losses reported in other comprehensive income.	½
The distinction between profit or loss and other comprehensive income does have some practical relevance, however.	½
The distinction is particularly important for **listed** entities. Such entities are required to report their **earnings per share** under IAS 33 – *Earnings per Share*. **Gains and losses reported in profit or loss affect earnings per share** whereas gains or losses reported in other comprehensive income **do not**.	½ + ½ + ½
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Query Two

The difference between the $64 million gain in the statement of comprehensive income and the $80 million gain included in property, plant and equipment is caused by deferred tax.	1
IAS 12 – *Income Taxes* – requires that deferred tax liabilities are recognised (with a very few exceptions) on all taxable temporary differences.	1
A taxable temporary difference arises when the carrying value of an asset increases but its 'tax base' does not.	1
When an asset is revalued, the carrying value increases but the tax base stays the same (as the future tax deductions are unaffected).	1
Therefore a revaluation of $80 million causes a taxable temporary difference of $80 million and (when the tax rate is 20%) an additional deferred tax liability of $16 million ($80 million x 20%).	1
This liability reduces the gain reported in the statement of comprehensive income to $64 million ($80 million – $16 million).	1
	6

Query Three

Under the provisions of IFRS 10 – *Consolidated Financial Statements* – the general rule is that the financial statements of all group members should have the same reporting date.	1
Where the reporting period of a subsidiary is different from the reporting period of the parent, that subsidiary should prepare, for consolidation purposes, additional financial information as of the same date as the financial statements of the parent.	1
Where it is 'impracticable' to prepare additional financial information, then the parent is permitted to consolidate the financial information of the subsidiary using the most recent financial information of the subsidiary 'adjusted for the effects of significant transactions or events in the intervening period'. 31 May 2017 to 30 September 2017 in this case.	1

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For the above to be possible, the intervening period should be no longer than three months, so in this case additional interim financial information will have to be prepared.	1
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Query Four

Under the provisions of IAS 24 – *Related Party Disclosures* – your son's business is a related party to Omega.	1
Your son's business is a related party because the business is controlled by your son, who is one of your 'close family members' and you are a part of Omega's 'key management'.	1
IAS 24 requires disclosure of all transactions with related parties irrespective of their size.	1
IAS 24 states that transactions with related parties are material by their nature.	1
	4
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