Diploma in International Financial Reporting (Dip IFR)

Friday 7 December 2018

IFR INT ACCA

Dip IFR

Time allowed: 3 hours 15 minutes

ALL FOUR questions are compulsory and MUST be attempted.

Do NOT open this question paper until instructed by the supervisor.

This question paper must not be removed from the examination hall.

Think Ahead ACCA

The Association of Chartered Certified Accountants

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The question paper begins on page 3.

ALL FOUR questions are compulsory and MUST be attempted

1 Alpha currently has investments in two other entities, Beta (Note 1) and Gamma (Note 2). The draft statements of financial position of Alpha and Beta at 30 September 2018 were as follows:

	Alpha $'000	Beta $'000
Assets		
Non-current assets:		
Property, plant and equipment (Notes 1and 5)	775,000	380,000
Investments (Notes 1–3)	410,000	Nil
	1,185,000	380,000
Current assets:		
Inventories (Note 4)	150,000	95,000
Trade receivables (Note 4)	100,000	80,000
Cash and cash equivalents	18,000	15,000
	268,000	190,000
Total assets	1,453,000	570,000
Equity and liabilities		
Equity		
Share capital ($1 shares)	520,000	160,000
Retained earnings	693,000	200,000
Total equity	1,213,000	360,000
Non-current liabilities:		
Long-term borrowings	100,000	80,000
Deferred tax	60,000	45,000
Total non-current liabilities	160,000	125,000
Current liabilities:		
Trade and other payables	60,000	55,000
Short-term borrowings	20,000	30,000
Total current liabilities	80,000	85,000
Total liabilities	240,000	210,000
Total equity and liabilities	1,453,000	570,000

Note 1 – Alpha's investment in Beta

On 1 October 2011, Alpha acquired 120 million shares in Beta and gained control of Beta on that date. The acquisition was financed by a cash payment by Alpha of $144 million to the former shareholders of Beta on 1 October 2011 and a further cash payment of $145·2 million to the former shareholders of Beta paid on 1 October 2013. The annual rate to use in any discounting calculations is 10% and the relevant discount factor is 0·826. Alpha correctly accounted for the payments made to the former shareholders of Beta in its own financial statements. The cost of investment figure in the financial statements of Alpha was rounded to the nearest $ million.

Alpha incurred due diligence costs of $1 million relating to the acquisition of Beta and included these costs in the carrying amount of its investment in Beta. On 1 October 2011, the individual financial statements of Beta showed retained earnings of $80 million.

The directors of Alpha carried out a fair value exercise to measure the identifiable assets and liabilities of Beta at 1 October 2011. The following matters emerged:

– Property which had a carrying amount of $120 million (land component $40 million) had an estimated fair value of $160 million (land component $60 million). The buildings component of the property had an estimated remaining useful life of 40 years at 1 October 2011.

– Plant and equipment having a carrying amount of $120 million had an estimated fair value of $130 million. The estimated remaining useful life of this plant at 1 October 2011 was two years.

– The fair value adjustments have not been reflected in the individual financial statements of Beta. In the consolidated financial statements, the fair value adjustments will be regarded as temporary differences for the purposes of computing deferred tax. The rate of deferred tax to apply to temporary differences is 20%.

On 1 October 2011, the directors of Alpha initially measured the non-controlling interest in Beta at its fair value on that date. On 1 October 2011, the fair value of an equity share in Beta (which can be used to measure the fair value of the non-controlling interest) was $1·70. No impairments of the goodwill on acquisition of Beta have been evident up to and including 30 September 2018.

Note 2 – Alpha's investment in Gamma

On 1 October 2015, Alpha acquired 36 million shares in Gamma by means of a cash payment of $145 million. Gamma's issued share capital at that date was 120 million shares. On 1 October 2015 and 30 September 2018, the individual financial statements of Gamma showed retained earnings of $45 million and $65 million respectively. Since 1 October 2015, no other investor has owned more than 2% of the shares of Gamma.

Note 3 – Alpha's investment in Delta

On 1 October 2012, Alpha issued 80 million of its own shares in exchange for an 80% shareholding in Delta. Delta has an issued share capital of 100 million shares. The fair value of an equity share in Alpha on that date was $1·40. The fair values of the net assets of Delta at 1 October 2012 were the same as their carrying amounts.

On 1 October 2012, the directors of Alpha initially measured the non-controlling interest in Delta at its fair value on that date. On 1 October 2012, the fair value of an equity share in Delta (which can be used to measure the fair value of the non-controlling interest) was $1·10.

The individual financial statements of Delta showed net assets at the following amounts:

– $110 million on 1 October 2012.
– $170 million on 30 September 2017.

In the year ended 30 September 2018, the individual financial statements of Delta showed a profit of $24 million. On 31 March 2018, Delta paid a dividend of $9 million.

On 30 June 2018, Alpha disposed of its shareholding in Delta for cash proceeds of $180 million. The individual financial statements of Alpha recognised the correct profit on disposal of its shareholding in Delta. No impairment of the goodwill on acquisition of Delta had been necessary between 1 October 2012 and 30 June 2018.

Note 4 – Intra-group trading

Alpha supplies a component to Beta at a mark-up of 25% on its production cost. The trade receivables of Alpha at 30 September 2018 include $10 million receivable from Beta in respect of sales of the component. Beta paid Alpha $10 million to clear the outstanding balance on 29 September 2018. Alpha received and recorded this amount on 3 October 2018.

On 30 September 2018, the inventories of Beta included $15 million in respect of components purchased from Alpha. All such inventory is measured at original cost to Beta.

Note 5 – Property lease

On 1 October 2017, Alpha began to lease a property under a 10-year lease. The annual rate of interest implicit in the lease was 5%. The lease rentals payable by Alpha were $10 million, payable annually in arrears. The lease does not transfer ownership of the property to Alpha at the end of the lease term. The lease contains no option for Alpha to purchase the property at the end of the lease term. On 1 October 2017, Alpha incurred direct costs of $4 million in arranging this lease. The only accounting entries made by Alpha in respect of this lease were to charge $14 million to the statement of profit or loss. Using a discount rate of 5%, the cumulative present value of $1 payable annually in arrears for ten years is $7·72.

Required:

(a) Compute the profit or loss on disposal of the investment in Delta which would be shown in the consolidated statement of profit or loss of Alpha for the year ended 30 September 2018. (7 marks)

(b) Prepare the consolidated statement of financial position of Alpha at 30 September 2018. You need only consider the deferred tax implications of any adjustments you make where the question specifically refers to deferred tax. (33 marks)

Note: You should show all workings to the nearest $'000.

(40 marks)

2 Epsilon is an entity which prepares financial statements to 30 September each year.

(a) Purchase of machine

On 1 April 2018, Epsilon accepted delivery of a large and complex machine from an overseas supplier. The agreed purchase price for the machine was 20 million francs – the functional currency of the supplier. Under the terms of the agreement with the supplier 12·6 million francs was payable on 31 July 2018, with the balance of 7·4 million francs being payable on 30 November 2018. The payment due on 31 July 2018 was made in accordance with the terms of the agreement. Epsilon does not use hedge accounting.

On 1 April 2018, Epsilon incurred direct costs of $250,000 in installing the machine at its premises. Although the machine was ready for use from 1 April 2018, Epsilon did not bring the machine into use until 30 April 2018. During April 2018 Epsilon incurred costs of $200,000 in training relevant staff to use the machine.

The directors of Epsilon estimate that the machine is capable of being usefully employed in the business until 31 March 2023, and that it will have no residual value at that date. (8 marks)

(b) Decommissioning

On 31 March 2023, Epsilon will be legally required to decommission the machine using the original supplier. The directors of Epsilon estimate that the cost of safely decommissioning the machine on 31 March 2023 will be 3 million francs.

Note: A relevant annual rate to be used in any discounting calculations is 8% and the appropriate discount factor is 0·681. (8 marks)

(c) Impairment review

During the final few months of the accounting period ending on 30 September 2018, Epsilon experienced difficult trading conditions. These difficulties did not affect the ability of Epsilon to operate as a going concern. In an impairment review of the machine at 30 September 2018, the directors of Epsilon estimated that the machine's recoverable amount was $2·5 million. (4 marks)

Relevant exchange rates (francs to $1) are as follows:

- 1 April 2018 – 10 francs to $1.
- 30 April 2018 – 9·5 francs to $1.
- 31 July 2018 – 9 francs to $1.
- 30 September 2018 – 8 francs to $1.
- Average rate for the period from 1 April 2018 to 30 September 2018 – 9·2 francs to $1.

Required:

Explain and show with appropriate calculations how the above events would be reported in the financial statements of Epsilon for the year ended 30 September 2018. Marks will be awarded for BOTH figures AND explanations.

(20 marks)

3 IAS® 33 – *Earnings per Share* – sets out requirements for the calculation and presentation of earnings per share in financial statements of listed entities. The requirements include the disclosure of basic earnings per share and, where an entity has potential ordinary shares in issue, the additional disclosure of diluted earnings per share in certain circumstances.

Kappa is a listed entity with a number of subsidiaries. Extracts from the consolidated statement of profit or loss and other comprehensive income of Kappa for the year ended 30 September 2018 appear below:

	Attributable to Kappa	Non-controlling interest	Total
	$'000	$'000	$'000
Profit for the year	39,000	3,000	42,000
Other comprehensive income	5,000	Nil	5,000
Total comprehensive income	44,000	3,000	47,000

The long-term finance of Kappa comprises:

(i) 200 million ordinary shares in issue at the start of the year. On 1 January 2018, Kappa issued 50 million new ordinary shares at full market value.

(ii) 80 million irredeemable preference shares. These shares were in issue for the whole of the year ended 30 September 2018. The dividend on these preference shares is discretionary.

(iii) $180 million 6% convertible loan stock issued on 1 October 2016 and repayable on 30 September 2021 at par. Interest is payable annually in arrears. As an alternative to repayment at par, the lenders on maturity can elect to exchange their loan stock for 100 million ordinary shares in Kappa. On 1 October 2016, the prevailing market interest rate for five-year loan stock which had no right of conversion was 8%. Using an annual discount rate of 8%, the present value of $1 payable in five years is $0·68 and the cumulative present value of $1 payable at the end of years one to five is $3·99.

In the year ended 30 September 2018, Kappa declared an ordinary dividend of 10 cents per share and a dividend of 5 cents per share on the irredeemable preference shares.

The annual rate of income tax applicable to Kappa and its subsidiaries is 20%.

All transactions have been correctly accounted for in the financial statements of Kappa for the year ended 30 September 2018.

Required:

(a) Explain the meaning of the term 'potential ordinary shares' and provide TWO examples of potential ordinary shares OTHER THAN convertible loans. (3 marks)

(b) Explain how the diluted earnings per share is calculated and when it needs to be disclosed. (3 marks)

(c) Compute the finance cost of the convertible loan stock which will be shown in the consolidated statement of profit or loss of Kappa for the year ended 30 September 2018 and the related loan liability which will be shown in the consolidated statement of financial position of Kappa at 30 September 2018. (6 marks)

(d) Compute the basic and diluted earnings per share amounts for Kappa for the year ended 30 September 2018 which will be presented in its consolidated financial statements for that year. (8 marks)

(20 marks)

4 You are the financial controller of Omega, a listed entity which prepares consolidated financial statements in accordance with International Financial Reporting Standards (IFRS® Standards). The financial statements for the year ended 30 September 2018 are due to be published shortly. A trainee accountant who is assigned to your department is reviewing the financial statements as part of a training exercise. She has prepared a list of queries arising out of this review.

Query One

When I look at the statement of financial position, one of the categories of non-current assets is 'investment properties' and another category is 'property, plant and equipment' – in which all other properties are included. Surely we invest in all our properties, so why have two categories for them in the statement of financial position? How do we decide what goes where?

A note to the financial statements states that investment properties are measured at their fair values and not depreciated. Don't all non-current assets have to be depreciated over their estimated useful lives? Another note states that property included in property, plant and equipment is measured at cost less accumulated depreciation rather than at fair value. Shouldn't all properties be measured in the financial statements on a consistent basis?

Finally, I can't immediately see from the financial statements where the gains or losses relating to the measurement of investment properties are included. The profit statement seems to include two main components – profit or loss and other comprehensive income. Where would the gains or losses go? Presumably the treatment of gains and losses is the same for any non-current assets which are measured at fair value? (10 marks)

Query Two

When I looked at the note detailing the intangible assets we include in our consolidated statement of financial position, I noticed that several brand names associated with subsidiaries we acquired recently were included in this figure. Therefore I also expected to see a figure for the Omega brand name included within intangible assets. There doesn't appear to be any amount for the Omega brand name included within intangible assets and I don't understand why. The Omega brand name has been developed within Omega for a number of years and is well regarded by our customers. Surely it's a mistake not to include it as well? (6 marks)

Query Three

One of the notes to the financial statements refers to a legal claim made against Omega by Customer X. This relates to losses incurred by Customer X due to Omega supplying this customer with a faulty product. Further investigation revealed that the fault was due to one of Omega's suppliers, Supplier Y, supplying Omega with a faulty component. This component was used to manufacture the product supplied to Customer X. Therefore Omega made a legal claim against Supplier Y in respect of that faulty component. The note states that both legal claims will probably succeed. I don't understand why Omega's financial statements include a liability in respect of the expected settlement of Customer X's legal claim but do not include an asset in respect of the expected settlement of Omega's legal claim against Supplier Y. This seems inconsistent. (4 marks)

Required:

Provide answers to the queries raised by the trainee. You should justify your answers with reference to relevant IFRS Standards.

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

(20 marks)

End of Question Paper