Answers

1 Consolidated statement of profit or loss and other comprehensive income of Alpha for the year ended 31 March 2018

	$'000	*Marks*
Revenue (W1)	1,448,000	1 (W1)
Cost of sales (W2)	(856,940)	11½ (W2)
Gross profit	591,060	
Distribution costs (38,000 + 34,000 + 27,000 x 8/12)	(90,000)	½
Administrative expenses (W6)	(153,100)	2½ (W6)
Investment income (W7)	8,000	1½ (W7)
Profit on disposal of Gamma (W8)	4,560	10 (W8)
Finance costs (W12)	(62,412)	2½ (W12)
Profit before tax	298,108	
Income tax expense (W13)	(86,000)	1
Profit for the year	212,108	
Other comprehensive income:		
Items that will not be reclassified to profit or loss		
Re-measurement loss on defined benefit retirement pension plan (W14)	(1,175)	3½ (W14)
Items that may be reclassified subsequently to profit or loss		
Gains on the re-measurement of financial assets classified as fair value through other comprehensive income	5,600	1
Total comprehensive income for the year	216,533	
Profit attributable to:		
Owners of Alpha (balancing figure)	182,348	½
Non-controlling interest (W15)	29,760	3 (W15)
	212,108	
Total comprehensive income attributable to:		
Owners of Alpha (balancing figure)	186,773	½
Non-controlling interest (as above)	29,760	1
	216,533	
		40

WORKINGS – ALL NUMBERS IN $'000 UNLESS OTHERWISE STATED.

Working 1 – Revenue

	$'000	
Alpha + Beta + 8/12 x Gamma	1,488,000	½
Intra-group revenue (25,000 + 15,000)	(40,000)	½
	1,448,000	1

Working 2 – Cost of sales

	$'000	
Alpha + Beta + 8/12 x Gamma	893,000	½
Intra-group purchases (as W1)	(40,000)	½
Unrealised profit:		
Closing inventory (1/4 x 6,400)	1,600	½
Opening inventory (1/4 x (4,800 + 4,000)	(2,200)	½ + ½
Impairment of Beta goodwill (W3)	3,000	5½ (W3)
Extra depreciation on fair value adjustments:		
Property (8,400 x 1/8 x 8/12)	700	½ + ½ + ½
Depreciation of 'right of use asset' (W5)	840	2 (W5)
	856,940	11½

Working 3 – Impairment of Beta goodwill

	$'000	*Marks*
Net assets at 31 March 2018 (as per SOCIE)	334,000	½
Goodwill arising on acquisition (W4)	15,000	3 (W4)
Notional grossing up of goodwill for impairment purposes (15,000 x 25/75)	5,000	½
	354,000	½
Recoverable amount	(350,000)	½
So impairment equals	4,000	
Recognise group share only (75%)	3,000	½
		5½
		⇒W2

Working 4 – Goodwill arising on acquisition of Beta

	$'000	
Cost of investment:		
Shares issued: (75,000 x ½ x $4·40)	165,000	½ + ½ + ½
Non-controlling interest at date of acquisition (200,000 x 25%)	50,000	1
Net assets at date of acquisition	(200,000)	½
So goodwill equals	15,000	3
		⇒W3

Working 5 – Depreciation of right of use asset

	$'000	
Present value of minimum lease payments (1,000 x $4·10)	4,100	1
Direct costs of arranging lease	100	½
	4,200	
Depreciation (4,200 x 1/5)	840	½
		2
		⇒W2

Working 6 – Administrative expenses

	$'000	
Alpha + Beta + 8/12 x Gamma	154,000	½
Reversal of incorrectly charged defined benefit plan contribution	(4,800)	½
Current service cost (award if alternatively taken to cost of sales)	5,000	½
Reversal of incorrectly charged lease charges (1,000 + 100)	(1,100)	½ + ½
	153,100	2½

Working 7 – Investment income:

	$'000	
Alpha	32,000	½
Intra-group dividends eliminated:		
– Beta (75% x 32,000)	(24,000)	½
– Gamma (paid post-disposal)	(nil)	½
	8,000	1½

Working 8 – Profit on disposal of Gamma

	$'000	
Disposal proceeds	196,000	½
Net assets of Gamma at date of disposal (W9)	(228,050)	4½ (W9)
Goodwill of Gamma at date of disposal (W10)	(10,000)	2½ (W10)
Non-controlling interest in Gamma at date of disposal (W11)	46,610	½ + 2 (W11)
So profit on disposal equals	4,560	10

Marks

Working 9 – Net assets of Gamma at date of disposal

	$'000	
Net assets at the start of the year (per SOCIE)	180,000	½
8/12 of profit for the period per accounts of Gamma (63,000 x 8/12)	42,000	1
Remaining fair value adjustments		½
Property [(12,000 – 8,400) + 8,400 x 28/96]	6,050	1 + 1
Plant and equipment	Nil	½
So net assets equals	228,050	4½
		⇒W8

Working 10 – Goodwill of Gamma at date of disposal

	$'000	
Cost of investment in Gamma	145,000	½
Non-controlling interest in Gamma at date of acquisition (10,000 x $3·50)	35,000	1
Fair value of net assets at date of acquisition:	(**170,000**)	½ + ½
So goodwill on acquisition equals	10,000	2½
		⇒W8

Working 11 – Non-controlling interest in Gamma at date of disposal

	$'000	
Non-controlling interest at date of acquisition (W10)	35,000	½
Increase since acquisition (**20%** (**228,050** (W9) – **170,000** (W10)))	11,610	½ + ½ + ½
So non-controlling interest on disposal equals	46,610	2
		⇒W8

Working 12 – Finance cost

	$'000	
Alpha + Beta + 8/12 x Gamma	62,000	½
Finance cost on leased asset (4,100 (W5) x 7%)	287	½ + ½
Unwinding of discount on net pension liability (2,500 x 5%)	125	½ + ½
	62,412	2½

Working 13 – Income tax expense

	$'000	
Alpha + Beta + 8/12 x Gamma	81,000	½
Income tax payable on the disposal of Gamma	5,000	½
	86,000	1

Working 14 – Re-measurement gain on defined benefit retirement pension plan

	$'000	
Net pension liability on 1 April 2017	2,500	½
Current service cost	5,000	½
Unwinding of discount (W12)	125	½
Contributions	(4,800)	½
Benefits paid to retired members (cancels)	Nil	½
	2,825	
Actuarial loss (balancing figure)	1,175	½
Net pension liability on 31 March 2018	4,000	½
		3½

Working 15 – Non-controlling interest in profit

	Beta $'000	Gamma (8/12) $'000	Total $'000	
Profit after tax	86,000	42,000		½ + ½
Extra depreciation – Gamma (W2)		(700)		½
Relevant profit	86,000	41,300		½
Non-controlling interest (25%/20%)	21,500	8,260	29,760	½ + ½
				3

			Marks
2	**(a)**	Under the principles of IFRS 9 – *Financial Instruments (revised 2014)* – Delta is permitted to use hedge accounting when reporting the hedging arrangement in its financial statements. This is because: – The relevant documentation has been prepared. – There is a clear economic relationship between the hedged cash flows and the hedging instrument. – Delta is entering into a forward purchase of exactly the required amount of foreign currency.	2 (½ for the overall decision and ½ for each component of the justification)
		The hedging instrument is a derivative financial instrument. Derivatives are normally measured at fair value in the financial statements with changes in fair value being recognised in profit or loss.	1
		On 31 March 2018, the derivative would be recognised in the financial statements as a current asset at its fair value of $2·7 million.	1
		The hedged item is designated to be the changes in the expected cash flows arising on the contact. For the year ended 31 March 2018, changes in the expected cash flows arising under the contract would not be recognised since the contract is an executory contract (a contract made by two parties in which the terms are set to be fulfilled at a later date).	1
		Since the hedging documentation indicates that the hedged item is the changes in the expected cash flows, then cash flow hedge accounting is used. In this case this involves comparing the change in the value of the derivative (the recognised hedging instrument) with the (unrecognised) changes in the value of the expected cash flows arising under the contract.	1
		To the extent that the change in the value of the derivative is less than or equal to the change in the value of the expected cash flows (the effective portion of the hedge), the change in value of the derivative is recognised in other comprehensive income rather than profit or loss. However, any over-hedging would result in any gains or losses arising on the hedging instrument which relate to the over-hedging (the ineffective portion of the hedge) being immediately being recognised in profit or loss.	1
		In this case the overall gain in fair value of the derivative between 1 January 2018 and 31 March 2018 is $2·7 million.	1
		In that same period, the change in the expected value of the cash flows arising under the contract is $2·6 million. Therefore $2·6 million of the gain on the derivative would be recognised in other comprehensive income with the balance of $100,000 being recognised in profit or loss	1
			9
	(b)	Under the principles of IAS 21 – *The Effects of Changes in Foreign Exchange Rates* – the purchase of inventory on 1 February 2018 would be recorded using the spot rate of exchange on that date. Therefore Delta would recognise a purchase and an associated payable of $600,000 (3·6 million dinars/6).	1 (principle) + 1 (calculation)
		Delta would recognise revenue of $480,000 in the statement of profit or loss because goods to the value of $480,000 were sold prior to 31 March 2018.	1
		Delta would recognise $360,000 ($600,000 x 60%) in cost of sales because the revenue of $480,000 is recognised.	1
		The closing inventory of goods purchased from the foreign supplier would be $240,000 ($600,000 – $360,000) and would be recognised as a current asset. This would not be re-translated since inventory is a non-monetary asset.	1 (principle) + 1 (calculation)
		The payment of 1,260,000 dinars on 15 March 2018 would be recorded using the spot rate of exchange on that date, therefore the payment would be recorded at $200,000 (1,260,000 dinars/$6·3).	1
		The closing payable of 2,340,000 dinars (3,600,000 dinars – 1,260,000 dinars) is a monetary item, therefore would be translated at the rate of exchange in force at the year end (6·4 dinars to $1). Therefore the closing payable (recorded in current liabilities) would be $365,625 (2,340,000 dinars/$6·4).	1 (principle) + 1 (calculation
		The difference between the initially recognised payable ($600,000) and the subsequently recognised payment ($200,000) is $400,000. Since the closing payable is $365,625 (see above), Delta has made an exchange gain of $34,375 ($400,000 – $365,625). This gain is recognised in the statement of profit or loss, either under other income category or as a reduction in cost of sales.	1 (principle) + 1 (calculation
			11
			20

Marks

3 (a) Under IFRS 9, the basis for classifying and measuring financial assets is the business model for managing the financial asset and the contractual cash flow characteristics of the financial asset. 1

Where the business model for managing the financial asset is to hold the financial asset to **collect the contractual cash flows** and where the contractual terms of the financial asset give rise **on specified dates to cash flows which are solely payments of principal and interest** on the principal amount outstanding, then the financial asset is measured at **amortised cost**. ½ + ½ + ½

Where the business model for managing the financial asset is to **both** hold the financial asset to collect the contractual cash flows **and** to sell the financial asset and where the contractual terms of the financial asset give rise on specified dates to cash flows which are solely payments of principal and interest on the principal amount outstanding, then the financial asset is measured at **fair value through other comprehensive income**. ½ + ½ + ½

If a financial asset is **not measured at amortised cost** or fair value through other comprehensive income, then it is measured at fair value through profit or loss (the default category).

An entity **can make an optional irrevocable election on initial recognition** that particular investments in equity instruments which would otherwise be measured at fair value through profit or loss be measured at fair value through other comprehensive income. This election is only possible if the **equity investment is *not* 'held for trading'**. ½ + ½ + ½

Notwithstanding the above, **an entity *may*, at initial recognition**, irrevocably **designate a financial asset as measured at fair value through profit or loss** if to do so **would eliminate or reduce a measurement or recognition inconsistency** which would otherwise arise from measuring assets or liabilities or recognising gains or losses on them on different bases (an 'accounting mismatch'). ½ + ½ + ½

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NB: Exact wordings NOT required for marks.

(b) (i) Since the business model is to collect the contractual cash flows and the cash flows consist solely of the repayment of principal and interest, this asset is measured at amortised cost. 1 (explanation)

The initial carrying amount of the financial asset will be $30·25 million ($30 million fair value + $250,000 transaction costs). 1

The finance income recorded under investment income category in the statement of profit or loss for the year ended 31 March 2018 will be $3·025 million ($30·25 million x 10%). 1

The carrying amount of the financial asset in the statement of financial position at 31 March 2018 will be $31·775 million ($30·25 million + $3·025 million – $1·5 million). 1

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(ii) Since this is an equity investment which Epsilon has no intention of selling, Epsilon can measure the investment at fair value through other comprehensive income (provided irrevocable election on initial recognition has been made). 1

Since the financial asset is measured at fair value through other comprehensive income, the transaction cost (agent's commission) is included in the initial fair value of shares (500,000 x $2 + $100,000). 2

The carrying amount of the financial asset in the statement of financial position at 31 March 2018 will be $1·125 million based on fair value of shares at the year end (500,000 x $2·25). 1

The difference (fair value gain) of $25,000 ($1·125 million – $1·1 million) will be recognised in other comprehensive income. 1

Dividend income of $150,000 (500,000 x 30 cents) will be recognised as other income in the statement of profit or loss. 1

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(iii) The call option cannot be measured at amortised cost or fair value through other comprehensive income, so it must be measured at fair value through profit or loss. 1

The initial carrying value of the call option will be $125,000 (100,000 x $1·25). 1

At the year end, the call option will be re-measured to its fair value of $160,000 (100,000 x $1·60). 1

	Marks
The fair value gain of $35,000 ($160,000 – $125,000) will be recognised in the statement of profit or loss.	1
	4
	20

4 Query One

The relevant IFRS which deals with operating segments is IFRS 8 – *Operating Segments*. The definition of an operating segment in IFRS 8 is based around an entity's business model, which could be different from entity to entity and the disclosures focus on the information which management believes is important when running the business. 1 (principle)

IFRS 8 defines an operating segment as a component of an entity:

– Which engages in business activities from which it may earn revenues and incur expenses, and
– Whose operating results are regularly reviewed by the chief operating decision maker, and
– For which discrete financial information is available.

2 (up to 2 for detail of definition)

The 'chief operating decision maker' is a role rather than a title or it is a function and not necessarily a person. The role/function is defined around who monitors performance and allocates resources of the operating segments. 1

IFRS 8 is only compulsory for **listed** entities. If we wanted to include information regarding the operating segments of individual subsidiaries, then we **could** as IFRS 8 requires judgement in its application. However, the information in the individual financial statements would **either need to comply with IFRS 8 in all respects or the information cannot be described as 'segment information'**. ½ + ½ + 1

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Query Two

IAS 16 – *Property, Plant and Equipment* (PPE) – allows (but does not require) entities to revalue its PPE to fair value. However, it requires that the measurement model used (cost or fair value) for PPE should be consistent on a class by class basis. 1 (principle)

A class of PPE is a **grouping of assets of a similar nature and use in an entity's operations**. Based on this definition, it is **likely that property (or 'land and buildings') would form one distinct class of PPE and that plant and equipment would form another class**. 1 + 1

Therefore it is perfectly consistent with IFRS for property to be measured under the revaluation (fair value) model and plant and equipment to be measured under the cost model. 1

However, it would be inappropriate to 'cherry pick' or apply a 'mixed measurement model' to property (or land and buildings) based simply on its geographical location. This prevents entities only revaluing items which have increased in value and leaving other items at their (depreciated) cost. 1

If we do use the fair value model, then we need to make sure we revalue with sufficient regularity to ensure that the carrying amount of the revalued asset is a true reflection of its current value. 1

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Query Three

Under the provisions of IAS 38 – *Intangible Assets* – the ability to recognise an intangible asset depends on how the potential asset arose. From the perspective of the Omega group, brand names generated by Omega are internally generated. The recognition criteria for such potential assets are very stringent and only costs associated with the development phase of an identifiable research and development project would satisfy them. This explains why the Omega brand names are not recognised. 1 (internally generated) + 2 (why cannot capitalise)

In contrast, intangible items which relate to an acquired subsidiary which exist at the date of acquisition are acquired as part of a business combination and for such assets the recognition criteria are different. Provided the fair value of such an intangible can be reliably measured at the date of acquisition, it is recognised in the consolidated statement of financial position based on its fair value at the date of acquisition. 1 (acquired with business combination) + 2 (mechanics of recognition)

The use of the fair value model for intangible non-current assets is restricted to those assets which are traded in an active market. This is relatively uncommon in the case of intangibles. It is most unlikely that brand names would be traded in such a market, so the fair value model is unlikely to be available here. 1 (principle) + 1 (conclusion)

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