

# Diploma in International Financial Reporting

Friday 8 June 2018



**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**

IFR  
Dip

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 holds investments in a number of entities, including Beta and Gamma. The statements of profit or loss and other comprehensive income and summarised statements of changes in equity of the three entities for the year ended 31 March 2018 were as follows:

**Statements of profit or loss and other comprehensive income**

	<b>Alpha \$'000</b>	<b>Beta \$'000</b>	<b>Gamma \$'000</b>
Revenue (Note 4)	628,000	560,000	450,000
Cost of sales (Notes 1, 2 and 4)	(378,000)	(335,000)	(270,000)
Gross profit	250,000	225,000	180,000
Distribution costs	(38,000)	(34,000)	(27,000)
Administrative expenses (Notes 5 and 7)	(64,000)	(56,000)	(51,000)
Investment income (Note 6)	32,000	Nil	Nil
Finance costs	(30,000)	(20,000)	(18,000)
Profit before tax	150,000	115,000	84,000
Income tax expense	(38,000)	(29,000)	(21,000)
Profit for the year	112,000	86,000	63,000
<b>Other comprehensive income:</b>			
<b>Items that will not be reclassified to profit or loss</b>			
Re-measurement gain/loss on defined benefit retirement pension plan (Note 7)	Nil	Nil	Nil
<b>Total comprehensive income</b>	<b>112,000</b>	<b>86,000</b>	<b>63,000</b>

**Summarised statements of changes in equity**

Balance on 1 April 2017	420,000	280,000	180,000
Comprehensive income for the year	112,000	86,000	63,000
Dividends paid on 31 December 2017	(42,000)	(32,000)	(21,000)
<b>Balance on 31 March 2018</b>	<b>490,000</b>	<b>334,000</b>	<b>222,000</b>

**Note 1 – Alpha's investment in Beta**

On 1 April 2011, Alpha acquired 75 million of the 100 million equity shares of Beta and gained control of Beta. Alpha acquired the equity shares in Beta by issuing one new share in Alpha for every two acquired in Beta. On 1 April 2011, the fair value of an equity share in Alpha was \$4.40.

On 1 April 2011, the net assets of Beta had a fair value of \$200 million, all of which had been disposed of, or settled by, 31 March 2017.

Alpha used the proportion of net assets method for measuring the non-controlling interest when recognising the goodwill on acquisition of Beta. No impairments of goodwill on acquisition of Beta have been necessary in the consolidated financial statements of Alpha up to and including 31 March 2017.

Beta is a single cash generating unit. On 31 March 2018, the annual impairment review indicated that the recoverable amounts of the net assets, including goodwill, of Beta at that date were \$350 million. Any impairments of goodwill should be charged to cost of sales.

**Note 2 – Alpha's investment in Gamma**

On 1 April 2012, Alpha acquired 40 million of the 50 million equity shares in Gamma and gained control of Gamma. Alpha paid \$145 million in cash for the equity shares.

On 1 April 2012, the carrying amounts of the net assets of Gamma in its individual financial statements were \$150 million and their fair values were \$170 million. The differences were caused by:

- Property – whose fair value exceeded the carrying amount by \$12 million. \$8.4 million of this difference referred to the depreciable component of this property. The estimated useful life of the depreciable component of the property at 1 April 2012 was eight years.
- Plant and equipment – whose fair value exceeded the carrying amount by \$8 million. The estimated remaining useful life of the plant and equipment of Gamma at 1 April 2012 was four years.

All depreciation of property, plant and equipment is charged to cost of sales.

Alpha used the fair value method for measuring the non-controlling interest when recognising the goodwill on acquisition of Gamma. The fair value of an equity share in Gamma on 1 April 2012 was \$3.50. This can be used to measure the fair value of the non-controlling interest in Gamma on 1 April 2012.

No impairments of goodwill on acquisition of Gamma have been necessary in the consolidated financial statements of Alpha up to and including 31 March 2017.

### Note 3 – Disposal of shares in Gamma

On 30 November 2017, Alpha disposed of its entire equity shareholding in Gamma for a cash consideration of \$196 million. Income tax payable on this disposal is expected to be \$5 million. On 30 November 2017, Alpha credited the disposal proceeds to a suspense account and has made no other accounting entries. You can assume that the profits of Gamma for the year ended 31 March 2018 accrued evenly.

### Note 4 – Intra-group trading

Alpha supplies a component which has been used by both Beta and Gamma. Alpha applies a mark-up of one-third to the cost of these supplies when computing the sales price. Details of sales of the component to Beta and Gamma in the current accounting period, and the holdings of inventory of the component by two entities, are as follows:

	Beta \$'000	Gamma \$'000
Sales of the component (for Gamma all sales before 30 November 2017)	25,000	15,000
Inventory of component at 31 March 2017 (at cost to Beta/Gamma)	4,800	4,000
Inventory of component at 31 March 2018 (at cost to Beta)	6,400	Nil

### Note 5 – Leased asset

On 1 April 2017, Alpha began to lease a property. The lease term was for five years. The lease does not transfer ownership of the property to Alpha at the end of the lease term. Alpha does not have an option to purchase the property at the end of the lease term. The estimated useful life of the property at 1 April 2017 was 20 years. Rentals payable by Alpha for the use of the property were \$1 million per annum, payable annually in arrears. Alpha incurred direct costs of \$100,000 in arranging to lease the property. In the year ended 31 March 2018, Alpha charged both the annual rental of \$1 million and the direct costs of \$100,000 to administrative expenses.

The rate of interest implicit in this lease is 7% per annum. The present value of \$1 payable for five years annually in arrears at a discount rate of 7% is \$4.10.

All depreciation should be charged to cost of sales.

### Note 6 – Investment income

The investment income, which is shown in Alpha's statement of profit or loss, represents dividends received from its subsidiary entities and also income arising from a portfolio of loan investments. This portfolio is classified by Alpha as fair value through other comprehensive income. The gain on re-measurement of the portfolio to fair value at 31 March 2018 was \$5.6 million. This gain has not yet been recognised in the financial statements of Alpha.

### Note 7 – Retirement benefit plan

Alpha has established a defined benefit plan for its workforce. Relevant details are as follows:

- The net defined benefit obligation at 31 March 2017 was \$2.5 million.
- The net defined benefit obligation at 31 March 2018 was \$4 million.
- The current service cost for the year ended 31 March 2018 was \$5 million.
- The contributions paid by Alpha into the plan during the year ended 31 March 2018 were \$4.8 million.

- The benefits paid out by the plan to retired members during the year ended 31 March 2018 were \$2.5 million.
- On 1 April 2017, the market yield on high quality corporate bonds was 5% per annum.

In the year ended 31 March 2018, Alpha charged the contributions paid to administrative expenses but made no other accounting entries. The post-employment plans for the employees of Beta and Gamma are defined contribution plans. The relevant accounting entries in the financial statements of both Beta and Gamma are both correct.

**Required:**

**Prepare the consolidated statement of profit or loss and other comprehensive income of Alpha for the year ended at 31 March 2018. You do not need to consider the deferred tax effects of any adjustments you make.**

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

**(40 marks)**

- 2 Delta is an entity which prepares financial statements to 31 March each year. The functional currency of Delta is the dollar (\$). The following events have occurred which are relevant to the year ended 31 March 2018:

**Event (a)**

On 1 January 2018, Delta entered into a contract with a foreign supplier. The terms of the contract were that the supplier would construct a large machine for Delta's use and deliver the machine on 30 June 2018. The total construction price of 20 million groats (the currency of the supplier) is due for payment on 31 July 2018.

On 1 January 2018, Delta entered into an agreement for the forward purchase of 20 million groats. The settlement date for this forward purchase of foreign currency was 31 July 2018. Delta intends to use this forward purchase as a hedge of the expected cash outflow flows arising under the construction contract on 31 July 2018.

Delta wishes to use hedge accounting for this arrangement if this is possible under International Financial Reporting Standards. Delta has prepared all relevant documentation which is necessary to enable hedge accounting to be used if the qualifying conditions are met.

Data relevant to the construction contract and to the forward purchase of currency is as follows:

- Increase in expected cash flows arising under the construction contract between 1 January 2018 and 31 March 2018 = \$2,600,000.
- Positive fair value of forward currency purchase contract at 31 March 2018 = \$2,700,000. (9 marks)

**Event (b)**

On 1 February 2018, Delta purchased some inventory from a supplier whose functional currency was the dinar. The total purchase price was 3.6 million dinars. The terms of the purchase were that Delta would pay for the goods in two instalments. The first instalment payment of 1,260,000 dinars was due on 15 March 2018 and the second payment of 2,340,000 dinars on 30 April 2018. Both payments were made on the due dates. Delta did not undertake any activities to hedge its currency exposure arising under this transaction. Delta sold 60% of this inventory prior to 31 March 2018 for a total sales price of \$480,000. All sales proceeds were receivable in \$. After 31 March 2018, Delta sold the remaining inventory for sales proceeds which were in excess of their cost.

Relevant exchange rates are as follows:

- 1 February 2018 – 6.0 dinars to \$1.
- 15 March 2018 – 6.3 dinars to \$1.
- 31 March 2018 – 6.4 dinars to \$1. (11 marks)

**Required:**

**Explain and show how the two events would be reported in the financial statements of Delta for the year ended 31 March 2018.**

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

**(20 marks)**

- 3 (a) One of the issues covered by IFRS 9 *Financial Instruments* (revised July 2014) is the classification and measurement of financial assets. The three possible measurement bases identified by the standard are:
- Amortised cost.
  - Fair value through other comprehensive income.
  - Fair value through profit or loss.

**Required:**

**Explain how IFRS 9 requires entities to select the appropriate measurement basis for a financial asset. You should include any options available to entities regarding classification in your explanation.**

**Note:** You are NOT required to define a financial asset. (7 marks)

- (b) Epsilon prepares financial statements to 31 March each year. The following events have occurred which are relevant to the year ended 31 March 2018:
- (i) On 1 April 2017, Epsilon loaned \$30 million to another entity. Interest of \$1.5 million is payable annually in arrears. An additional final payment of \$35.3 million is due on 31 March 2020. Epsilon incurred direct costs of \$250,000 in arranging this loan. The annual rate of interest implicit in this arrangement is approximately 10%. Epsilon has no intention of assigning this loan to a third party at any time. (4 marks)
- (ii) On 1 April 2017, Epsilon purchased 500,000 shares in a key supplier – entity X. The shares were purchased in order to protect Epsilon's source of supply and Epsilon has no intention of trading in these shares. The shares cost \$2 per share and the direct costs of purchasing the shares were \$100,000. On 1 January 2018, the supplier paid a dividend of 30 cents per share. On 31 March 2018, the fair value of a share in entity X was \$2.25. (5 marks)
- (iii) On 1 January 2018, Epsilon purchased 100,000 call options to purchase shares in entity Y – an unconnected third party. Each option allowed Epsilon to purchase shares in entity Y on 31 December 2018 for \$6 per share. Epsilon paid \$1.25 per option on 1 January 2018. On 31 March 2018, the fair value of a share in entity Y was \$8 and the fair value of a share option purchased by Epsilon was \$1.60. This purchase of call options is not part of a hedging arrangement. (4 marks)

**Required:**

**Explain and show how the three events should be reported in the financial statements of Epsilon for the year ended 31 March 2018. In part (b) you should assume that Epsilon only measures financial assets at fair value through profit or loss when *required* to do so by IFRS 9.**

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

**(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). The chief executive officer (CEO) of Omega has reviewed the draft consolidated financial statements of the Omega group and of a number of the key subsidiary companies for the year ended 31 March 2018. None of the subsidiaries are listed entities but all prepare their financial statements in accordance with IFRS. The CEO has sent you an email with the following queries:

**Query One**

I notice that the disclosures relating to operating segments in the consolidated financial statements appear to be based on the geographical location of the customers of the group. I am the non-executive director of another large listed entity and the segment disclosures in their consolidated financial statements are based on the type of products sold. Also some of our larger subsidiaries have customers located in more than one geographical region, yet they provide no segment disclosures whatsoever in their individual financial statements. I would like to see segment disclosures given in the individual subsidiary accounts as well. I really don't understand these inconsistencies given that all these financial statements have been prepared using IFRS. Please explain the reasons for these apparent inconsistencies.

(6 marks)

**Query Two**

When reading the accounting policies note in the consolidated financial statements I notice that we measure all of our freehold properties using a fair value model but that we measure our plant and equipment using a cost model. I further notice that both of these asset types are shown in the 'property, plant and equipment' figure which is a single component of non-current assets in the consolidated statement of financial position. It makes no sense to me that assets which are shown as property, plant and equipment are measured inconsistently. If it's OK to measure different parts of property, plant and equipment using two different measurement models, why not use the fair value model for the more readily accessible properties and use the cost model for the properties in remote locations to save on time and cost?

(6 marks)

**Query Three**

When I read the disclosure note relating to intangible non-current assets in the consolidated financial statements, I notice that this figure includes brand names associated with subsidiaries which we've acquired in recent years. However, the brand names which are associated directly with products sold by Omega (the parent entity) are not included within the non-current assets figure. This is another inconsistency that I don't understand. Please explain how this practice can be in line with IFRS requirements. One final question: would I be right in thinking that, as with property, plant and equipment, we can use the fair value model to measure intangible assets?

(8 marks)

**Required:**

**Provide answers to the three queries raised by the chief executive officer. Your answers should refer to relevant provisions of International Financial Reporting Standards.**

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

**(20 marks)**

**End of Question Paper**