Diploma in International Financial Reporting (Dip IFR)

Friday 6 December 2019

IFR INT ACCA EN

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.

Dip IFR

Think Ahead ACCA

The Association of Chartered Certified Accountants

ALL FOUR questions are compulsory and MUST be attempted

1 Alpha, a parent with a subsidiary Beta, is preparing the consolidated statement of financial position at 30 September 20X7. The draft statements of financial position for both entities as at 30 September 20X7 are given below:

	Alpha $'000	Beta $'000
Assets		
Non-current assets:		
Property, plant and equipment (note 1)	966,500	546,000
Development project (note 1)	0	20,000
Investment in Beta (note 1)	450,000	0
	1,416,500	566,000
Current assets:		
Inventories (note 2)	165,000	92,000
Trade receivables	99,000	76,000
Cash and cash equivalents	18,000	16,000
	282,000	184,000
Total assets	1,698,500	750,000
Equity and liabilities		
Equity		
Share capital ($1 shares)	360,000	160,000
Retained earnings	570,000	360,000
Other components of equity	102,000	0
Total equity	1,032,000	520,000
Non-current liabilities:		
Long-term borrowings (note 3)	300,000	85,000
Pension liability (note 4)	187,500	0
Deferred tax (note 1 and 2)	69,000	54,000
Total non-current liabilities	556,500	139,000
Current liabilities:		
Trade and other payables	70,000	59,000
Short-term borrowings	40,000	32,000
Total current liabilities	110,000	91,000
Total equity and liabilities	1,698,500	750,000

Note 1 – Alpha's investment in Beta

On 1 April 20X7, Alpha acquired 120 million shares in Beta. Alpha made a payment of $450 million in exchange for these shares. The individual interim financial statements of Beta showed a balance of $340 million on its retained earnings on 1 April 20X7.

The directors of Alpha carried out a fair value exercise to measure the identifiable assets and liabilities of Beta at 1 April 20X7. The following matters emerged:

– Plant and equipment having a carrying amount of $440 million had an estimated fair value of $480 million. The estimated remaining useful life of this plant and equipment at 1 April 20X7 was four years.

– An in-process development project of Beta's had a carrying amount of $8 million and a fair value of $18 million. During the six-month period from 1 April 20X7 to 30 September 20X7, Beta incurred further development costs of $12 million relating to this project. These costs were correctly capitalised in accordance with the requirements of IAS® 38 – *Intangible Assets*. No amortisation of the capitalised costs of this project was required prior to 30 September 20X7.

– 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 April 20X7, the directors of Alpha measured the non-controlling interest in Beta at its fair value on that date. On 1 April 20X7, the fair value of an equity share in Beta was $3·80.

Note 2 – Intra-group trading
Since 1 April 20X7, Alpha has supplied a product to Beta. Alpha applies a mark-up of 25% to its cost of supplying this product. Sales of the product by Alpha to Beta in the period from 1 April 20X7 to 30 September 20X7 totalled $30 million. One-third of the products which Alpha has supplied to Beta since 1 April 20X7 were still unsold by Beta at 30 September 20X7. Any adjustment which is necessary in the consolidated financial statements as a result of these sales will be regarded as a temporary difference for the purposes of computing deferred tax. The rate of deferred tax to apply to temporary differences is 20%. No amounts were owing to Alpha by Beta in respect of these sales at 30 September 20X7.

Note 3 – Long-term borrowings
Prior to 1 October 20X6, Alpha had no long-term borrowings. On 1 October 20X6, Alpha borrowed $300 million to finance its future expansion plans. The term of the borrowings is five years and the annual rate of interest payable on the borrowings is 6%, payable in arrears. Alpha charged the interest paid on 30 September 20X7 as a finance cost in its financial statements for the year ended 30 September 20X7.

The borrowings are repayable in cash at the end of the five-year term or convertible into equity shares on that date at the option of the lender. If the borrowings had not contained a conversion option, the lender would have required an annual return of 8%, rather than 6%. Discount factors which may be relevant are as follows:

Discount factor	Present value of $1 payable at the end of year 5	Cumulative present value payable at the end of years 1–5 inclusive
6%	74·7 cents	$4·21
8%	68·1 cents	$3·99

Note 4 – Pension liability
Alpha has established a defined benefit pension plan for its eligible employees. The statement of financial position of Alpha at 30 September 20X7 currently includes the estimated net liability at 30 September 20X6. The following matters relate to the plan for the year ended 30 September 20X7:

– The estimated current service cost was advised by the actuary to be $60 million.

– On 30 September 20X7, Alpha paid contributions of $70 million into the plan and charged this amount as an operating expense.

– The annual market yield on high quality corporate bonds on 1 October 20X6 was 8%.

– The estimated net liability at 30 September 20X7 was advised by the actuary to be $205 million.

No benefits have been paid to date.

Required:

Using the draft statements of financial position of Alpha and its subsidiary Beta at 30 September 20X7, and the further information provided in notes 1–4, prepare the consolidated statement of financial position of Alpha at 30 September 20X7. Unless specifically told otherwise, you can ignore the deferred tax implications of any adjustments you make.

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

(25 marks)

2 Gamma prepares its financial statements to 30 September each year. Notes 1 and 2 contain information relevant to these financial statements:

Note 1 – Purchase of equity shares in a key supplier

On 1 October 20X6, Gamma purchased 200,000 equity shares in entity A, a key supplier. Entity A's shares are listed on the local stock exchange. This share purchase did not give Gamma control or significant influence over entity A but Gamma intends to retain the shares in entity A as a long-term strategic investment.

Gamma paid $2·40 per share for these shares. This amount represents their fair value at the date of purchase. Additionally, brokers charge a fee of 2% of the amounts paid to buy or sell a share on the stock exchange on which entity A's shares are quoted.

On 31 March 20X7, entity A paid a dividend of 25 cents per share. For the last few years entity A has made just one dividend payment each year, in the month of March.

On 30 September 20X7, information received from the local stock exchange regarding entity A's share price was:

– Broker's bid price (the price the broker will pay to buy a share) – $2·70 per share.

– Broker's ask price (the price which the broker requires when selling a share) – $2·90 per share. (13 marks)

Note 2 – Jointly manufactured product

On 1 October 20X6, Gamma entered into an agreement with entity B to manufacture and sell a product.

Under the terms of the agreement, pricing decisions, manufacturing specifications and selling decisions must be agreed by both entities. Any relevant obsolescence risk or bad debt risk is jointly borne by both entities.

Entity B completes the first stage and the partially manufactured product is then transferred to Gamma who completes the manufacture and delivers the product to the customer. Gamma invoices the customer and collects payment.

Entity B receives no payment for the goods they have manufactured until they are sold and the customer has paid Gamma.

Revenue from the sale of the completed product is shared equally between Gamma and entity B. Each month Gamma pays entity B its share of any amounts received from customers in the previous month. Under the terms of the agreement, the payments to entity B must be made within two weeks of the end of each month.

Financial data relevant to the agreement for the year ended 30 September 20X7 is as follows:

Relating to the manufacture of the product:

	Entity B	**Gamma**
	$m	**$m**
Manufacturing costs	8	7
Inventories at 30 September 20X7	2	3·8 (note (i))

Relating to the sale of the product:

	$m
Revenue	22
Trade receivables at 30 September 20X7 (note (ii))	5
Bad debts written off (note (iii))	0·1

Notes:

(i) $2·1 million of this cost related to costs incurred by entity B and $1·7 million related to costs incurred by Gamma. All inventory is measured using IAS 2 – *Inventories*.

(ii) Amounts received from customers during September 20X7 were $1·5 million.

(iii) No further bad debts are expected. (12 marks)

Required:

Explain and show how the two events detailed in notes 1 and 2 would be reported in the financial statements of Gamma for the year ended 30 September 20X7. Where alternative reporting treatments are permitted in note 1, you should explain and show both alternatives. Marks will be awarded for BOTH figures AND explanations.

Note: The mark allocation is shown against the two notes above.

(25 marks)

3 (a) IFRS® 15 – *Revenue from Contracts with Customers* – was issued in September 2015 and applies to accounting periods beginning on or after 1 January 2018. IFRS 15 replaces IAS 11 – *Construction Contracts* – and IAS 18 – *Revenue*. IFRS 15 contains principles which underpin the timing of the recognition of revenue from contracts with customers and the measurement of that revenue.

Required:

Explain the principles underpinning the TIMING of revenue recognition and the MEASUREMENT of that revenue which are outlined in IFRS 15. You should provide examples of revenue transactions to support your explanations of these key principles. (12 marks)

(b) Delta prepares financial statements to 30 September each year. Notes 1 and 2 provide information on revenue transactions relevant to the year ended 30 September 20X7.

Note 1 – Sale of product with right of return

On 1 April 20X7 Delta sold a product to a customer for $121,000. This amount is payable on 30 June 20X9. The manufacturing cost of the product for Delta was $80,000. The customer had a right to return the product for a full refund at any time up to and including 30 June 20X7. At 1 April 20X7, Delta had no reliable evidence regarding the likelihood of the return of the product by the customer. The product was not returned by the customer before 30 June 20X7 and so the right of return for the customer expired. On both 1 April 20X7 and 30 June 20X7, the cash selling price of the product was $100,000. A relevant annual rate to use in any discounting calculations is 10%. (7 marks)

Note 2 – Sale with a volume discount incentive

On 1 January **20X6** Delta began an arrangement to sell goods to a third party – entity B. The price of the goods was set at $100 per unit for all sales in the two-year period ending 31 December 20X7. However, if sales of the product to entity B exceed 60,000 units in the two-year period ending 31 December 20X7, then the selling price of **all** units is retrospectively set at $90 per item.

Sales of the goods to entity B in the nine-month period ending on 30 September **20X6** totalled 20,000 units and this volume of sales per month was not expected to change before 31 December 20X7.

However, in the year ended 30 September **20X7**, total sales of the goods to entity B were 35,000 and based on current orders from entity B, the estimate was revised. The directors of Delta estimated that the total sales of the goods to entity B in the two-year period ending 31 December 20X7 would be more than 60,000 units.

(6 marks)

Required:

Explain and show how the transactions in notes 1 and 2 would be reported in the financial statements of Delta for the year ended 30 September 20X7.

Note: The mark allocation is shown against the two transactions in the separate notes above.

(25 marks)

4 Epsilon, a company with a year end of 30 September 20X7, is listed on a securities exchange. A director of Epsilon has a number of questions relating to the application of International Financial Reporting Standards (IFRS® Standards) in its financial statements for the year ended 30 September 20X7. The questions appear in notes 1–3.

Note 1 – Inconsistencies

I have recently been appointed to the board of another company which is growing very quickly and will probably seek a securities exchange listing in the next few years. As part of my familiarisation process, I've been reviewing their financial statements which they state comply with IFRS Standards. I have been comparing them with the financial statements of Epsilon. There appear to be some inconsistencies between the two sets of financial statements:

- The financial statements of the other company contain no disclosure of the earnings per share figure and there is no segmental analysis despite this company having a number of divisions with different types of business. Epsilon gives both of these disclosures.
- Both Epsilon and this other company have received government grants to assist in the purchase of a non-current asset. We have deducted the grant from the cost of the non-current asset. They have recognised the grant received as deferred income.

Please explain the apparent inconsistencies to me. (7 marks)

Note 2 – Pending legal cases

At a recent board meeting, we discussed legal cases which customers A and B are bringing against Epsilon in respect of the supply of products which were allegedly faulty. We supplied the goods in the last three months of the financial year.

We have reliably estimated that if the actions succeed, we are likely to have to pay out $10 million in damages to customer A and $8 million in damages to customer B.

Epsilon's legal advisers have reliably estimated that there is a 60% chance that customer A's claim will be successful and a 25% chance that customer B's claim will be successful.

I know we have insurance in place to cover us against claims like this. It is highly probable that any claims which were successful would be covered under our policy. Therefore I would have expected to see a provision for legal claims based on the likelihood of the claims succeeding. However, I would also have expected to see an equivalent asset in respect of amounts recoverable from the insurance company. The financial statements do contain a provision for $10 million but no equivalent asset. Disclosure of the information relating to both of the claims and the associated insurance is made in the notes to the financial statements. How can it be the correct accounting treatment to include a liability but not the corresponding asset, given the above facts? (12 marks)

Note 3 – Statement of profit or loss and other comprehensive income

I've been reviewing the statement of profit or loss and other comprehensive income and it appears to be in two sections. The first section appears to be entitled 'profit or loss' and the second 'other comprehensive income'. It appears that the tax charge is included in the 'profit or loss' section of the statement as there is no tax charge included in the 'other comprehensive income' section of the statement. I have a number of questions regarding this statement:

- How do we decide where to put a particular item of income or expenditure?
- Where does the tax relating to 'other comprehensive income' get shown?
- Do the above points have an impact on the computation of performance evaluation indicators which will be of interest to shareholders? (6 marks)

Required:

Provide answers to the questions raised by the director in notes 1–3. You should justify your answers with reference to relevant International Financial Reporting Standards.

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

(25 marks)

End of Question Paper