Diploma in International Financial Reporting

MONDAY 12 DECEMBER 2005

QUESTION PAPER

Time allowed **3 hours**

This paper is divided into two sections

Section A	This ONE question is compulsory and MUST be answered
Section B	THREE questions ONLY to be answered

Do not open this paper until instructed by the supervisor

This question paper must not be removed from the examination hall

The Association of Chartered Certified Accountants

Section A – This ONE question is compulsory and MUST be attempted

1 Alpha has owned 80% of the equity shares of Beta since the incorporation of Beta. Therefore Alpha has prepared consolidated financial statements for some years. On 1 June 2005 Alpha purchased 35% of the equity shares of Gamma. The income statements and summarised statements of changes in equity of the three entities for the year ended 30 September 2005 are given below:

Income statements

	Alpha	Beta	Gamma
	$'000	$'000	$'000
Revenue (Note 1)	150,000	100,000	96,000
Cost of sales	(110,000)	(78,000)	(66,000)
Gross profit	40,000	22,000	30,000
Distribution costs	(7,000)	(6,000)	(6,000)
Administrative expenses	(8,000)	(7,000)	(7,200)
Profit from operations	25,000	9,000	16,800
Investment income (Note 2)	6,280	Nil	Nil
Finance cost	(5,000)	(3,000)	(4,200)
Profit before tax	26,280	6,000	12,600
Income tax expense	(7,000)	(1,800)	(3,600)
Net profit for the period	19,280	4,200	9,000
Summarised statements of changes in equity			
Balance at 1 October 2004	122,000	91,000	82,000
Net profit for the period	19,280	4,200	9,000
Dividends paid on 30 June 2005	(6,500)	(2,500)	(4,800)
Balance at 30 September 2005	134,780	92,700	86,200

Notes to the financial statements

Note 1 – Inter-company sales

Alpha sells products to Beta, making a profit of 25% on the cost of the products sold. Details of the purchases of the products by Beta together with the amounts included in opening and closing inventories in respect of the products, are given below:

Purchased in year	Included in opening inventory	Included in closing inventory
$'000	$'000	$'000
20,000	2,000	3,000

There were no other inter-company sales between Alpha, Beta or Gamma during the period.

Note 2 – Investment income

Alpha's investment income includes dividends received from Beta and Gamma and interest receivable from Beta. The dividend received from Gamma has been credited to the income statement of Alpha without time apportionment. The interest receivable is in respect of a loan of $20 million to Beta at a fixed rate of interest of 8% per annum. The loan has been outstanding for the whole of the year ended 30 September 2005.

Note 3 – Details of acquisitions by Alpha

Entity	Date of acquisition	Goodwill on acquisition	Fair value adjustment at date of acquisition
		$'000	$'000
Beta	1 July 1994	Nil	Nil
Gamma	1 June 2005	8,400	7,200

The goodwill figure for Gamma is after taking account of the fair value adjustment. This goodwill has not suffered impairment since 1 June 2005.

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The fair value adjustment has the effect of increasing the fair value of property, plant and equipment above the carrying value in the individual financial statements of Gamma. Group policy is to depreciate property, plant and equipment on a monthly basis over its estimated useful economic life. The estimated life of the property, plant and equipment of Gamma that was subject to the fair value adjustment is five years, with depreciation charged against cost of sales.

Note 4 – other information

– The purchase of shares in Gamma followed a contractual arrangement with two other investors to obtain joint control over Gamma from 1 June 2005. The contract requires that all three investors approve the key policy decisions of Gamma.
– All equity shares in Beta carry one vote at general meetings.
– The policy of Alpha regarding the treatment of equity investments in its consolidated financial statements is as follows:
  – Subsidiaries are fully consolidated.
  – Joint ventures are proportionally consolidated.
  – Associates are equity accounted.
  – Other investments are treated as available for sale financial assets.

Your assistant has been reading the working papers for the consolidated financial statements of Alpha for previous years. He has noticed that Beta has been consolidated as a subsidiary and has expressed the view that this must be because Alpha owns more than 50% of its shares. He has further stated that Gamma should be consolidated as an associate because Alpha owns more than 20% but less than 50% of its shares.

Required:

(a) **Prepare the consolidated income statement and consolidated statement of changes in equity of Alpha for the year ended 30 September 2005. Notes to the consolidated income statement are not required.** (20 marks)

(b) **Assess the observations of your assistant regarding the appropriate method of consolidating Beta and Gamma. Your assessment need NOT include an explanation of the detailed mechanics of consolidation. You should refer to the provisions of international financial reporting standards where you consider they will assist your explanation.** (5 marks)

(25 marks)

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Section B – THREE questions ONLY to be attempted

2 Delta is an entity that prepares its financial statements to 30 September each year. The financial statements for the year ended 30 September 2005 are being prepared and you are provided with the following trial balance at that date.

	$'000	$'000
Revenue		130,000
Development costs (Note 1)	12,000	
Production costs	75,000	
Distribution costs	7,000	
Administrative expenses (Note 2)	26,000	
Inventories at 30 September 2004 (Note 3)	18,200	
Interest paid and payable on interest bearing borrowings	3,000	
Income tax (Note 4)		200
Dividends paid on equity shares	2,000	
Property, plant and equipment – at cost (Notes 5 and 6)	57,000	
Accumulated depreciation on property, plant and equipment at 30 September 2004 (Notes 5 and 6)		15,590
Suspense account (Note 6)		1,200
Trade receivables	44,000	
Cash and cash equivalents	33,790	
Trade payables		12,000
Provisions (Note 2)		4,000
Long term interest bearing borrowings		40,000
Lease rentals (Note 7)	8,000	
Deferred tax (Note 4)		6,000
Issued equity capital		50,000
Accumulated profits		27,000
	285,990	285,990

Notes to the Trial Balance

Note 1 – Development costs
The development costs relate to a project started on 1 January 2005 to develop a new product. Costs of $1 million per month were incurred for the six months to 30 June 2005. On this date the project was assessed as being technically feasible and commercially viable. Further costs totalling $6 million were incurred between 1 July 2005 and 30 September 2005 and at 30 September 2005 the development of the new product was substantially complete. Commercial production is due to begin on 1 January 2006 and the directors are confident that the new product will generate net cash flows that have a present value far in excess of the costs incurred on the project.

Note 2 – Administrative expenses
Administrative expenses include a provision of $4 million for the costs of a legal claim lodged against Delta by one of its customers before 30 September 2005. The customer is claiming $10 million and the directors of Delta consider that there is a 40% chance the claim will be successful and so have provided for 40% of the total claim.

Note 3 – Inventories at 30 September 2005
The carrying value of inventories at 30 September 2005 was $22 million. This figure was computed in accordance with the principles of IAS 2 – *Inventories*.

Note 4 – Tax
- The estimated income tax on the profits for the year to 30 September 2005 is $1·5 million.
- During the year $1·9 million was paid in full and final settlement of income tax on the profits for the year ended 30 September 2004. The balance sheet at 30 September 2004 had included $2·1 million in respect of this liability.
- At 30 September 2005 the carrying values of the net assets of Delta exceeded their tax base by $28 million.
- The rate of income tax in the jurisdiction in which Delta operates is 25%.

Note 5 – Property, plant and equipment
Details are as follows:

	Property		Plant and
	Land	Buildings	equipment
	$'000	$'000	$'000
Cost at 30 September 2005 (but see Note 6 below)	12,000	18,000	27,000
Estimate of useful economic life (at date of purchase)	Infinite	50 years	4 years
Accumulated depreciation **at 30 September 2004**	0	4,500	11,090

Depreciation of property, plant and equipment is allocated as follows:
– 80% to cost of sales.
– 10% to distribution costs.
– 10% to administrative expenses.

For all tangible non-current assets depreciation is charged in full in the year of purchase, with no depreciation being charged in the year of sale.

None of the non-current assets were fully depreciated at 30 September 2004. The above allocation excludes any depreciation charged on the leased asset (see note 7 below) which should be fully charged to cost of sales.

Note 6 – Suspense account
During the year plant and equipment costing $6 million and having been depreciated by a cumulative amount of $4·5 million at 30 September 2004 was disposed of and the proceeds credited to a suspense account. Any gain or loss on the sale of plant and equipment should be treated as an adjustment to the relevant depreciation expense.

Note 7 – Lease rentals
On 1 October 2004 Delta began to lease a group of machines that were used in the production process. The lease was for five years and the six-monthly rental (payable in arrears) was $4 million. The lessor paid $31 million for the machines on 30 September 2004. The lessor has advised Delta that the lease is a finance lease and that the rate of interest implicit in the lease can be taken as 5% per half year.

Note 8 – Share issue
On 1 November 2005 Delta issued a further 10 million ordinary shares for $30 million. The shares have no par value and the share issue has not been reflected in the trial balance that appears above.

Required:

(a) Prepare the income statement for Delta for the year ended 30 September 2005. (12 marks)

(b) Prepare the statement of changes in equity for Delta for the year ended 30 September 2005. (4 marks)

(c) Prepare the balance sheet for Delta as at 30 September 2005. (9 marks)

Notes to the income statement and balance sheet are not required. However, your workings should justify your treatment of items referred to in the trial balance and the notes with appropriate references to international financial reporting standards.

(25 marks)

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3 You are the accountant of Epsilon, an entity that has business interests all around the world. The financial statements for the year ended 30 September 2005 are currently in the process of preparation. Where international financial reporting standards have been published before the year-end but mandatory compliance is deferred to a later period, the directors always follow the provisions of such standards from their date of publication. The directors have sought your advice on the financial reporting implications of the following issues:

1. On 31 August 2005 the directors decided to close down a business segment. The decision was taken out of a desire to refocus the strategic direction of the group and the segment being closed did not fit into the new strategy. The closure commenced on 15 October 2005 and was due to be completed on 31 December 2005. On 10 September 2005 letters were sent to employees offering voluntary redundancy or redeployment in other sectors of the business. On 13 September 2005 negotiations commenced with relevant parties with a view to terminating existing contracts of the business segment and arranging sales of its assets. Latest estimates of the financial implications of the closure are as follows:
   (a) Redundancy costs will total $20 million.
   (b) The pension plan will make a lump sum payment totalling $10 million to the employees who accept voluntary redundancy in termination of their rights under the plan. Epsilon will pay this amount into the plan on 31 January 2006.
   (c) The cost of redeploying and retraining staff who do not accept redundancy will total $6·5 million.
   (d) The costs of terminating existing contracts, including professional fees, will total $5 million.
   (e) Plant having a net book value of $12 million at 30 September 2005 will be sold for $1 million.
   (f) A freehold property having a net book value of $10 million at 30 September 2005 will be sold for $15 million. The potential purchaser is not interested in acquiring the plant.
   (g) The operating losses of the business segment for October, November and December 2005 will total $9 million. (12 marks)

2. In 2006 Epsilon is planning a major investment in Europe. Latest indications are that this investment will cost 40 million euros and that the funds will be required on 28 February 2006. In order to provide a measure of certainty regarding the cost of the investment the directors entered into a contract prior to the year end to purchase 40 million euros for $45 million, with a delivery date of 28 February 2006. On 30 September 2005 the forward rate of exchange was such that this contract had a fair value of $500,000 (a financial asset). (5 marks)

3. Epsilon has a subsidiary located in Farland. Farland has its own tax jurisdiction and no other group entity is located within it. The subsidiary regularly sells goods to Epsilon and the inventory of Epsilon at 30 September 2005 included goods purchased from its subsidiary on which its subsidiary had made a profit of $1 million [after translation at the appropriate rate]. The subsidiary had made a loss adjusted for tax purposes for the year ended 30 September 2005 that was equivalent to $4 million. Local tax legislation only allows tax losses to be carried forward for relief against future trading profits. The directors of Epsilon consider that the loss of the subsidiary is due to identifiable non-recurring causes and that the subsidiary will record a taxable profit for the foreseeable future. Both Epsilon and its subsidiary pay tax at 30%. (8 marks)

Required:

Advise the directors on the financial reporting implications of the three issues in the consolidated financial statements for the year ended 30 September 2005. For each issue you should indicate the amounts that would be included in the financial statements and the nature of any disclosures that might be appropriate in the notes. You should justify your conclusion with reference to appropriate international financial reporting standards and include any other explanations you consider relevant.

The allocation of marks to each individual issue is given above after the description of the issue.

(25 marks)

4 IAS 18 – *Revenue* – was issued with a view to standardising the recognition and measurement of revenue. The principles of the standard are based around the concept of income that was developed in the IASB's *Framework for the Preparation and Presentation of Financial Statements*.

Required:

(a) Explain how the IASB framework defines income and how this definition compares to the definition of revenue given in IAS 18. (4 marks)

(b) Outline the requirements of IAS 18 regarding the recognition and measurement of revenue from:

(i) The sale of goods;
(ii) The rendering of services;
(iii) The use of entity assets. (9 marks)

Iota prepares financial statements to 30 September each year. During the year ended 30 September 2005 Iota engaged in the following transactions:

1. On 1 October 2004 Iota sold a plot of land to a bank for $10m. The land had a book value of $5m and a market value of $15m at the date of sale. Iota continued to develop the land and had a call option to buy the land back from the bank for $12m on 30 September 2006. The bank had a put option to sell the land to Iota for $12m on 30 September 2006.
2. On 30 September 2005 Iota sold some products under a two year warranty scheme. The total invoiced price was $500,000. The scheme requires Iota to repair any defects found in the products for a two year period from the date of sale. The directors of Iota can reliably estimate that their warranty costs will average $50,000 each year. A reasonable profit margin on the repair of such products is 20% of the normal invoiced price of such repairs.
3. On 1 October 2004 Iota sold some products for a total invoiced price of $600,000. The consideration was receivable from the customer on 30 September 2006. Iota normally charges a finance cost of 8% per annum on transactions for which it provides finance.

Required:

(c) Explain how each of the transactions 1–3 should be recognised in the financial statements of Iota for the year ending 30 September 2005. You should quantify the amounts recognised and make reference to relevant provisions of IAS 18 wherever possible. (12 marks)

(25 marks)

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5 Kappa is an entity that regularly purchases subsidiaries. Kappa prepares financial statements to 30 September each year. In its year ended 30 September 2003 Kappa purchased a new subsidiary, Omega, and began to amortise the goodwill on consolidation of Omega over an estimated useful economic life of 20 years.

On 30 June 2005 the entity acquired all the 100 million equity shares of Lambda by issuing one share in Kappa for every two shares acquired in Lambda. On 30 June 2005 the market value of a Kappa share was $5·40 and the market value of Lambda share $2·40.

The directors of Lambda prepared a balance sheet as at 30 June 2005 and the net assets of Lambda that were included were measured at $180 million (their fair values at that date). The directors of Kappa noted that the following assets of Lambda had not been included in the draft balance sheet prepared by the directors:

(i) Internally developed brands having an identifiable fair value of $10 million at 30 June 2005.
(ii) The value of future services of existing employees that was estimated to have a value of $15 million at 30 June 2005.

Required:

(a) Calculate the goodwill arising on initial consolidation of Lambda at 30 June 2005 and explain (without performing any calculations) how its carrying amount at 30 September 2005 would be measured. You should refer to relevant International Financial Reporting Standards to support your conclusions. (8 marks)

On 30 September 2005 Kappa carried out a review of the goodwill on consolidation of Lambda for evidence of impairment. The review was carried out despite the fact that there were no obvious indications of adverse trading conditions for Lambda. The review involved allocating the net assets of Lambda into three cash-generating units and computing the value in use of each unit. The carrying values of the individual units before any impairment adjustments are given below:

	Unit A	Unit B	Unit C
	$m	$m	$m
Patents	5	–	–
Property, plant and equipment	60	30	40
Net current assets	20	25	20
	85	55	60
Value in use of unit	72	68	65

It was not possible to meaningfully allocate the goodwill on consolidation to the individual cash generating units but all the other net assets of Lambda are allocated in the table shown above. The patents of Lambda have no ascertainable market value but all the current assets have a market value that is above carrying value. The value in use of Lambda as a single cash generating unit at 30 September 2005 is $205 million.

Required:

(b) Explain briefly the purpose of an impairment review and why the net assets of Lambda were allocated into cash generating units as part of a review of goodwill for impairment. (5 marks)

(c) Demonstrate how the impairment loss in unit A will affect the carrying value of the net assets of unit A in the consolidated financial statements of Kappa. (5 marks)

(d) Explain and calculate the effect of the impairment review on the carrying value of the goodwill on consolidation of Lambda at 30 September 2005. (7 marks)

(25 marks)

End of Question Paper

Diploma in International Financial Reporting

MONDAY 13 JUNE 2005

QUESTION PAPER

Time allowed **3 hours**

This paper is divided into two sections

Section A	This ONE question is compulsory and MUST be answered
Section B	THREE questions ONLY to be answered

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Section A – This ONE question is compulsory and MUST be attempted

1 The balance sheets of Alpha and its subsidiaries Beta and Gamma at 31 March 2005 (the accounting date for all three entities) are given below:

	Alpha		Beta		Gamma	
	$'000	$'000	$'000	$'000	$'000	$'000
ASSETS						
Non-current assets:						
Property, plant and equipment	28,000		25,000		20,000	
Financial assets (Notes 1-3)	49,000		nil		nil	
		77,000		25,000		20,000
Current assets:						
Inventories (Note 4)	18,000		12,000		11,000	
Trade and other receivables (Note 4)	15,000		10,000		9,000	
		33,000		22,000		20,000
Total assets		110,000		47,000		40,000
EQUITY AND LIABILITIES						
Capital and reserves:						
Issued capital ($1 shares)	25,000		15,000		10,000	
Share premium account	10,000		10,000		4,000	
Accumulated profits	36,000		8,000		9,300	
		71,000		33,000		23,300
Non-current liabilities						
Interest bearing borrowings	20,000		nil		4,000	
Deferred tax	2,000		1,000		1,500	
		22,000		1,000		5,500
Current liabilities						
Trade and other payables (Note 5)	12,000		9,000		7,000	
Short term borrowings	5,000		4,000		4,200	
		17,000		13,000		11,200
Total equity and liabilities		110,000		47,000		40,000

Notes to the balance sheets

Note 1
On 1 July 1990, the date of incorporation of Beta, Alpha purchased all the shares of Beta for $25 million.

Note 2
(i) On 1 April 2003 Alpha purchased eight million shares in Gamma for a cash payment of $2·80 per share. On 1 April 2003 the accumulated profits of Gamma stood at $12 million.
(ii) The fair value exercise that followed the acquisition of Gamma indicated that any fair value adjustments were not material in a group context.

Note 3
Prior to the publication of IFRS 3 – Business combinations – goodwill on consolidation was amortised over its estimated useful economic life of 20 years. Alpha adopted IFRS 3 in its financial statements for the first time in the current year. Accordingly the goodwill on consolidation of Gamma was reviewed for impairment at 31 March 2005. Gamma was viewed as a single cash-generating unit that at 31 March 2005 had a value in use of $24 million.

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Note 4
The issued capital of all three entities comprises entirely ordinary shares.

Note 5
(i) Alpha supplies a component to Beta and Gamma at cost plus a mark up of 20%.
(ii) At 31 March 2005 the inventories of Beta included $1·5 million and the inventories of Gamma $1·2 million in respect of this component.
(iii) At 31 March 2005 the trade receivables of Alpha showed an amount receivable from Beta of $1·2 million, whilst the trade payables of Beta showed an amount payable to Alpha of $600,000. On 29 March 2005 Alpha sent a consignment of components to Beta at an invoiced price of $600,000. The consignment was received and recorded by Beta on 2 April 2005.
(iv) At 31 March 2005 the trade receivables of Alpha and the trade payables of Gamma showed an intra-group balance of $800,000.

Note 6
The directors of Alpha are concerned that Gamma has been making losses since acquisition. They would prefer not to include these losses in the consolidated financial statements and have heard that International Financial Reporting Standards allow the results of subsidiaries to be omitted in certain circumstances. They have indicated that Gamma supplies customers that operate mainly in the retail sector, whilst Alpha and Beta have customers that operate mainly in the manufacturing sector. Therefore they have suggested that consolidation of Gamma would be misleading in such circumstances.

Required:

(a) Prepare the consolidated balance sheet of Alpha as at 31 March 2005. (20 marks)

(b) Write a memorandum to the directors of Alpha that:

(i) Describes the circumstances in which non-consolidation of subsidiaries is appropriate under International Financial Reporting Standards.

(ii) Responds to the issues they have raised in Note 6 above. (5 marks)

(25 marks)

DipIFR 05 June Questions

Section B – THREE questions ONLY to be attempted

2 Delta is an enterprise that prepares its financial statements to 31 March each year. The financial statements for the year ended 31 March 2005 are being prepared and you are provided with the following trial balance at that date.

	$'000	$'000
Revenue		132,000
Production costs	90,000	
Distribution costs	8,000	
Administrative expenses	12,000	
Inventories at 31 March 2004 (Note 1)	18,200	
Interest paid and payable on interest bearing borrowings (Note 2)	3,000	
Income tax (Note 3)	100	
Dividends paid on equity shares	2,000	
Land and buildings (Note 4)	50,000	
Plant and equipment (Note 4)	37,000	
Accumulated depreciation on property, plant and equipment:		
– Land and buildings (Note 4)		3,360
– Plant and equipment (Note 4)		10,500
Trade receivables	44,000	
Bank balances	28,560	
Trade payables		10,000
Long term interest bearing borrowings (Note 2)		30,000
Deferred tax (Note 3)		4,000
Issued preferred shares (Note 2)		20,000
Issued equity capital		40,000
Revaluation reserve at 31 March 2004 (Note 5)		4,000
Accumulated profits		39,000
	292,860	292,860

Notes to the Trial Balance

Note 1 – Inventories

(a) Inventories at 31 March 2005 had cost the entity $20 million. This figure included $960,000 in respect of a consignment of parts that had been purchased from a European supplier on 31 January 2005 for €800,000. These parts were unused at 31 March 2005. Payment (in Euros) was made to the supplier on 31 May 2005. Relevant exchange rates were as follows:

Date	Exchange rate ($s to 1 Euro)
31 January 2005	1·2
31 March 2005	1·3
31 May 2005	1·35

Delta credited $960,000 to trade payables on 31 January 2005 and has made no other entries regarding this transaction in the trial balance that appears above.

(b) On 15 April 2005 a water leak damaged some inventory that was included in the year end inventory figure at its cost of $500,000. As a result it had to be sold later in April 2005 for only $200,000. Apart from this inventory there was no other inventory held at 31 March 2005 that was likely to be disposed of for less than its cost.

Note 2 – Issue of preferred shares

On 1 April 2004 Delta issued 20 million $1 preferred shares at par. Issue costs of $200,000 were included as an administrative expense. The shares carry no dividend but are to be redeemed on 31 March 2009 at $1·60 per share. This represents an effective annual finance cost of 10%.

Note 3 – Tax

(i) The estimated income tax on the profits for the year to 31 March 2005 was $2·2 million.

(ii) During the year $2·1 million was paid in full and final settlement of income tax on the profits for the year ended 31 March 2004. Payables at 31 March 2004 had included $2 million in respect of this liability.

(iii) At 31 March 2005 the carrying value of the property, plant and equipment of Delta exceeded its tax base by $18 million. This does **not** include the taxable temporary difference caused by the revaluation of the property (see note 5 below). Delta had no other taxable or deductible temporary differences at 31 March 2005.

(iv) The rate of income tax in the jurisdiction in which Delta operates is 25%.

Note 4 – Property, plant and equipment

Details are as follows:

	Property		Plant and equipment	
	Land	**Buildings**	**Plant**	**Fixtures**
	$'000	**$'000**	**$'000**	**$'000**
Cost/Revalued amount at 31 March 2005 (see note 5)	22,000	28,000	28,000	9,000
Depreciation rate (%)	0	3	25	20
Depreciation method	None	Straight line	Straight line	Straight line
Accumulated depreciation **at 31 March 2004**	0	3,360	8,000	2,500

Depreciation of property, plant and equipment is allocated as follows:

(i) Plant and buildings to cost of sales.

(ii) Fixtures to administrative expenses

Note 5 – Property revaluation

(i) **On 31 March 2005** Delta revalued its property to its market value of $55 million. This figure is **not reflected** in note 4 above or in the current balance on the revaluation reserve.

(ii) The revaluation created a taxable temporary difference of $3 million.

Required:

(a) Prepare the income statement for Delta for the year ended 31 March 2005. (12 marks)

(b) Prepare the statement of changes in equity for Delta for the year ended 31 March 2005. (5 marks)

(c) Prepare the balance sheet for Delta as at 31 March 2005 (8 marks)

Notes to the income statement and balance sheet are not required. However your workings should justify your treatment of items referred to in the trial balance and the notes with appropriate references to International Financial Reporting Standards.

(25 marks)

DipIFR 05 June Questions

3 You are the accountant of Lambda. Lambda operates in a jurisdiction that requires International Financial Reporting Standards to be used for local reporting purposes. Your assistant is responsible for preparing the financial statements for your review. He is in the process of preparing the first draft of the financial statements for the year ended 31 March 2005. Whilst he has a sound basic knowledge of accounting he is unsure about certain aspects of financial reporting. He has asked you a number of questions regarding the financial reporting practices of the group.

(a) As you know on 1 April 2004 our company granted 50 executives call options to purchase up to 5,000 shares each on 1 April 2006. This was partly a means of deferring them from leaving as the options only vest if the executives are still employed on 1 April 2006. Personnel tell me that they estimate 90% of the executives will remain with us for the two year period and exercise their options in full. I am very confused by some of the financial information I have been given regarding these options:

(i) The option price is \$20 per share.
(ii) The market value of each share was \$15 on 1 April 2004 and \$18 on 31 March 2005. It is \$19 today.
(iii) The market value of the share option was \$2 on 1 April 2004 and \$2·20 on 31 March 2005. It is \$2·25 today.

I have made no accounting entries in the draft financial statements regarding these options. I base this on the fact that the option price is greater than the current market value so is unlikely to be exercised. Is my thinking correct on this? (8 marks)

(b) You will recall that on 1 March 2005 we entered into negotiations with employee representatives to restructure our operations and close down two of our five retail outlets. I understand that broad agreement was reached with the representatives on 25 March 2005 and the plans publicly announced on 27 March 2005. Relevant employees were sent letters on 28 March 2005 offering them redundancy or redeployment. The restructuring was completed on 31 May 2005. I have been advised that the financial effects of the closure were as follows:

(i) We incurred closure costs of \$1 million, including redundancy payments of \$400,000.
(ii) Costs of redeploying existing employees totalled \$200,000.
(iii) Plant and equipment was scrapped at a loss of \$150,000.
(iv) The properties of the two outlets were sold at a profit of \$300,000.
(v) The operating losses of the two outlets from 1 April 2005 to 31 May 2005 totalled \$100,000.
(vi) The net sum of all the above is a cost of \$1,150,000.

I have made a provision of \$1,150,000 in the draft financial statements and shown a closure cost of \$1,150,000 in the income statement. I have also shown the results of the outlets for the year to March 2005 as discontinued operations since they are being closed down. However I have left the net assets of the retail outlets in their normal balance sheet captions because they were not sold until after 31 March 2005. Have I got this right? (9 marks)

(c) On 1 April 2004 we issued 1 million loan notes at \$1 each. The loan notes carry an interest rate of 6% and are repayable on 31 March 2007. Alternatively the holders can elect to exchange a note for shares in Lambda on 31 March 2007. If this option were not available to them they would require an interest rate of 9%. I have shown this as a non-current liability of \$1 million, with a finance cost of \$60,000 in the income statement. Am I right to do this?

EXTRACTS FROM PRESENT VALUE TABLES:
Present value of \$ received at the end of year 'N'

	6%	9%
N = 1	0·943	0·917
N = 2	0·890	0·842
N = 3	0·840	0·772

(8 marks)

Required:

Draft a reply to each of the queries raised by your assistant. You should make reference to International Financial Reporting Standards where relevant and explain the rationale behind your replies.

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

(25 marks)

DipIFR 05 June Questions

4 Extracts from the financial statements of Omicron for the year ended 31 March 2005 are given below:

Income statements – year ended 31 March:

	2005	2004
	$'000	$'000
Revenue	600	500
Cost of sales	(300)	(240)
Gross profit	300	260
Other operating expenses	(156)	(145)
Profit from operations	144	115
Investment income	6	15
Finance cost	(50)	(45)
Profit on sale of property (note 1)	10	
Profit before tax	110	85
Income tax expense	(33)	(25)
Profit for the period	77	60

Statements of changes in equity – year ended 31 March

	2005	2004
	$'000	$'000
Equity at start of period	217	182
Profit for the period	77	60
Dividends paid	(25)	(25)
Equity at end of period	269	217

Balance sheets as at 31 March:

	2005		2004	
	$'000	$'000	$'000	$'000
ASSETS:				
Non-current assets:				
Property, plant and equipment (note 2)	240		280	
Development expenditure (note 3)	25		19	
		265		299
Current assets:				
Inventories	105		90	
Trade and other receivables	120		100	
Cash and cash equivalents	30		75	
		255		265
		520		564
EQUITY AND LIABILITIES				
Capital and reserves:				
Issued capital	100		100	
Revaluation reserve	Nil		20	
Accumulated profits	169		97	
		269		217
Non-current liabilities:				
Interest bearing borrowings	30		90	
Obligations under finance leases	80		70	
Deferred tax	29		24	
		139		184
Current liabilities:				
Trade and other payables (note 4)	75		63	
Short term borrowings (note 5)	12		80	
Obligations under finance leases	25		20	
		112		163
		520		564

Notes to the financial statements

Note 1 – profit on sale of property

A large freehold property was sold by Omicron on 1 October 2004 and leased back on an operating lease. The property was not depreciated in the current year. The property had been revalued in 2001 and the revaluation surplus credited to a revaluation reserve. No other entries had been made in the revaluation reserve prior to the sale of the property.

Note 2 – property, plant and equipment

	31 March 2005	31 March 2004
	$'000	$'000
Freehold land and buildings	Nil	90
Owned plant and equipment	150	120
Leased plant and equipment	90	70
	240	280

During the year Omicron entered into new finance lease agreements in respect of certain items of plant and equipment. The amounts debited to non-current assets in respect of such agreements during the year totalled $40,000. No disposals of plant and equipment (owned **or** leased) took place during the year. Depreciation of non-current assets for the year totalled $58,000.

Note 3 – development expenditure
This comprises the umamortised balance that is capitalised in accordance with the provisions of IAS 38 – *Intangible Assets*. Omicron charged amortisation of $10,000 to the income statement during the current period in accordance with the provisions of IAS 38.

Note 4 – trade and other payables

	31 March 200 $'000	31 March 2004 $'000
Trade payables	57	50
Income taxes payable	10	8
Accrued interest	8	5
	75	63

Note 5 – cash and cash equivalents
In the jurisdiction in which Omicron reports short term borrowings are regarded as part of cash and cash equivalents.

Required:

(a) **Prepare the cash flow statement of Omicron for the year ended 31 March 2005 in the form required by IAS 7 – Cash Flow Statements. You should use the indirect method to compute the operating cash flows. Notes to the cash flow statement are NOT required but your workings must be clearly shown.** (20 marks)

(b) **Explain, without reworking any figures:**

(i) **What would be reported in the cash flow statement if the direct method were used to compute the operating cash flows.**

(ii) **How the amounts that are reported under the direct method would be obtained.**

(iii) **Why the IASB encourages entities to use the direct method rather than the indirect method.** (5 marks)

(25 marks)

DipIFR 05 June Questions

5 Sigma is an entity that operates a defined benefit retirement benefits plan into which it makes contributions. On 31 March 2002 the balance sheet of Sigma showed a net liability relating to retirement benefit obligations as follows:

	$'000
Market value of plan assets	60,000
Present value of plan liabilities	(70,000)
Cumulative unrecognised actuarial losses	5,000
	(5,000)

Information relating to the plan for the next three years is as follows:

	Year ending 31 March		
	2003	2004	2005
	$'000	$'000	$'000
Market value of plan assets at the start of the year	60,000	62,000	64,000
Present value of plan liabilities at start of the year	70,000	84,000	96,000
Expected return on assets	3,000	3,200	3,500
Current service cost	6,000	6,400	6,500
Employer contributions to the plan	4,000	4,300	4,400
Benefits paid out	3,500	3,600	3,600
Market value of plan assets at the end of the year	62,000	64,000	66,000
Present value of plan liabilities at the end of the year	84,000	96,000	108,000
Discount rate at the start of the year	10%	9%	8%

Any actuarial gains and losses that fall outside the relevant corridor limits are to be recognised in the income statement as soon as the excess arises.

Required:

(a) **Explain why IAS 19 – Employee Benefits – requires a method of accounting by the employer for retirement benefit plans that differs depending on the type of plan and outline the accounting requirements for defined contribution plans.** (4 marks)

(b) **Describe the accounting requirements of IAS 19 for defined benefit plans in the financial statements of the employer.** (6 marks)

(c) **Prepare appropriate extracts from the income statements and the balance sheets to show the effects of the retirement benefits plan covering each of the three years ending on 31 March 2003, 2004 and 2005 for Sigma.** (15 marks)

(25 marks)

End of Question Paper

Diploma in International Financial Reporting

MONDAY 11 DECEMBER 2006

QUESTION PAPER

Time allowed **3 hours**

This paper is divided into two sections

Section A	This ONE question is compulsory and MUST be answered
Section B	THREE questions ONLY to be answered

Do not open this paper until instructed by the supervisor

This question paper must not be removed from the examination hall

The Association of Chartered Certified Accountants

Section A – This ONE question is compulsory and MUST be attempted

1 The income statements and summarised statements of changes in equity of Alpha, Beta and Gamma for the year ended 30 September 2006 are given below:

Income Statements

	Alpha	Beta	Gamma
	$'000	$'000	$'000
Revenue	125,000	100,000	90,000
Cost of sales	(70,000)	(60,000)	(51,000)
Gross profit	55,000	40,000	39,000
Other operating expenses	(20,000)	(15,000)	(15,000)
Income from investments	9,000	5,000	4,500
Finance costs	(11,000)	(8,000)	(7,500)
Profit before tax	33,000	22,000	21,000
Income tax expense	(9,000)	(6,000)	(5,400)
Profit for the year	24,000	16,000	15,600

Summarised Statements of Change in Equity

	Alpha	Beta	Gamma
Balance at 1 October 2005	110,000	60,000	56,000
Profit for the year	24,000	16,000	15,600
Dividends paid	(14,000)	(5,000)	nil
Balance at 30 September 2006	120,000	71,000	71,600

Notes to the Financial Statements

Note 1

(i) On 1 October 2002 Alpha purchased an 80% equity shareholding in Beta. The equity of Beta as shown in its own financial statements at that date was $35 million. At the date of acquisition Beta owned some land with a book value of $25 million and a market value of $35 million, and some plant with a book value of $12 million and a market value of $16 million. The plant is depreciated on a straight line basis and the remaining useful economic life of the plant at 1 October 2002 was estimated at four years.

(ii) On 1 February 2006 Alpha purchased a 75% shareholding in Gamma. At the date of acquisition Gamma had registered a brand name that had a fair value of $27 million. Gamma had not recognised this amount in its own individual financial statements. The directors of Alpha estimated that this brand would provide Gamma with significant competitive advantage for a 15-year period from 1 February 2006.

(iii) Other than mentioned in notes (i) and (ii) above there were no fair value adjustments necessary on acquisition of Beta or Gamma.

(iv) Alpha presents depreciation and amortisation charges as part of cost of sales.

(v) No impairment of goodwill on acquisition of either company has been identified up to and including 30 September 2006.

(vi) In addition to the equity investments made by Alpha in Beta and Gamma, on 1 February 2006 Alpha lent $20 million to Beta at an effective annual interest rate of 8%.

Note 2

Alpha supplies products used by Beta and Gamma. Sales of the products to Beta and Gamma during the year ended 30 September 2006 were as follows (all sales were made at a mark up of 25% on cost):

– Sales to Beta $10 million.
– Sales to Gamma (all in the post-acquisition period) $3 million.

DipIFR 06 Dec Questions

At 30 September 2006 and 30 September 2005 the inventories of Beta and Gamma included the following amounts in respect of goods purchased from Alpha.

	Amount in inventory at:	
	30/9/2006	30/9/2005
	$'000	$'000
Beta	2,000	1,200
Gamma	1,000	Nil

Required:

(a) Prepare the consolidated income statement and summarised consolidated statement of changes in equity for Alpha for the year ended 30 September 2006. Ignore deferred tax. (20 marks)

(b) Explain – WITHOUT reworking your answer in detail – the effect on the statements required in part (a) were deferred tax to be taken into account. (5 marks)

(25 marks)

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Section B – THREE questions ONLY to be attempted

2 Delta's accounting year end is 30 September. The trial balance of Delta as at 30 September 2006 showed the following balances:

	$'000	$'000
Revenue (Note 1)		240,000
Purchases	90,000	
Employment costs (Note 2)	60,000	
Operating overheads (Note 2)	45,000	
Inventories as at 1 October 2005 (Note 3)	35,000	
Property, plant and equipment (Notes 4 and 5):		
– At cost 30 September 2006	100,000	
– Accumulated depreciation at 1 October 2005		26,500
Construction contract (Note 6)	7,000	
Financial asset (Note 7)	12,500	
Investment income (Note 7)		500
Long term loan (fixed rate of interest 10% per annum)		30,000
Interest paid on long term loan	3,000	
Trade receivables	50,000	
Cash and bank balances	43,300	
Trade and other payables		30,000
Current tax payable (Note 8)	200	
Deferred tax at 1 October 2005 (Note 9)		4,000
Equity share capital (ordinary shares of $1)		50,000
Share premium account		40,000
Dividend paid on ordinary shares	5,000	
Retained earnings at 1 October 2005		30,000
	451,000	451,000

Notes to the trial balance

Note 1 – Revenue

On 29 September 2006 Delta sold a consignment of products for $30 million and credited the entire amount to revenue, the debit entry being to trade receivables. The terms of sale of the products were that Delta would provide an after sales service which required Delta to correct any defects that became apparent in the products for a one year period from the date of sale. The directors of Delta estimated that the cost of correcting defects in the consignment over the relevant period would be $1 million. A reasonable gross profit margin for corrective work of this nature would be 20%.

Note 2 – Apportionment of costs

Employment costs and operating overheads (including depreciation and impairment of property, plant and equipment) should be apportioned between cost of sales, distribution costs and administrative expenses in the ratio 7:1:2.

Note 3 – Inventories

The carrying value of closing inventories at 30 September 2006 was $40 million.

Note 4 – Property, plant and equipment

	Cost at 30/09/06 $'000	Accumulated depreciation at 01/10/05 $'000
Properties	40,000	3,800
Plant and equipment	60,000	22,700
Total	100,000	26,500

Property, plant and equipment is depreciated on a straight line basis (with a full year's charge in the year of purchase and no charge in the year of sale) at the following rates:

– 2% per annum for properties.

– 25% per annum for plant and equipment (other than that used on the construction contract – see note 6 below)

Note 5 – Revaluation of properties
On 30 September 2006 the properties were revalued to their market values as indicated below:

	Cost at 30/9/06	Accumulated Depreciation at 01/10/05	Market Value at 30/09/06
	$'000	$'000	$'000
Property A	15,000	1,500	20,000
Property B	15,000	300	18,000
Property C	10,000	2,000	6,000
	40,000	3,800	44,000

This revaluation is not reflected in the trial balance of Delta but the directors wish to reflect it in the financial statements.

Note 6 – Construction contract
On 1 January 2006 Delta commenced a construction contract that was estimated to last for a period of 24 months. Costs incurred on the contract to date (and debited to the contract account) and estimated future costs are as follows:

	Costs to Date	Estimated future Costs
	$'000	$'000
Materials	5,000	3,000
Plant and equipment	6,000	–
Overheads	4,000	6,000

The purchased plant and equipment is not expected to have any residual value at the end of the contract.

The contract price was fixed at $32 million. On 20 September 2006 an independent expert certified that 25% of the contract work had been completed satisfactorily. The customer immediately made a progress payment of $8 million, which Delta received on 27 March 2006 and credited to the contract account.

Note 7 – Financial asset
On 1 October 2005 Delta purchased a loan investment that had a nominal value of $10 million at a cost of $12·5 million. The investment entitled the holder to a fixed rate of interest of 5% on the nominal value of the loan. Delta designated the investment as fair value through profit and loss. The investment had a fair value of $13 million at 30 September 2006.

Note 8 – Current tax payable
The current tax payable figure at 1 October 2005 comprised $5 million in respect of the estimated income tax liability of Delta for the year ended 30 September 2005. This liability was finally agreed at $5·2 million in early 2006 and this amount was duly paid and debited to current tax payable. The estimated income tax liability for the year ended 30 September 2006 is $6 million. The rate of income tax that is relevant for Delta is 20%.

Note 9 – Deferred tax
A transfer of $500,000 needs to be made to the deferred tax account at 30 September 2006. This transfer does not include any potential deferred tax implications of the properties revaluation (see note 5 above)

Required:

(a) Prepare the income statement for Delta for the year ended 30 September 2006. (11 marks)

(b) Prepare the statement of changes in equity for Delta for the year ended 30 September 2006. (3 marks)

(c) Prepare the balance sheet for Delta as at 30 September 2006. (11 marks)

Notes to the income statement and balance sheet are not required. However your workings should justify your treatment of items referred to in the trial balance and the notes with appropriate references to international financial reporting standards.

(25 marks)

DipIFR 06 Dec Questions

3 You are the chief accountant of Epsilon. An executive of Epsilon, who is not an accountant but takes keen interest in financial matters, has reviewed the most recent financial statements of the entity and compiled a series of questions:

1. The accounting policies note states that purchased goodwill is included in the balance sheet and reviewed annually for impairment. The note also states that internally generated goodwill is not recognised in the balance sheet. Surely it is inconsistent to include purchased goodwill whilst not recognising internally generated goodwill? I also don't understand the meaning of the word 'impairment'. Please explain it to me and also explain how we would review goodwill for impairment. (9 marks)

2. The accounting policies note also states that our investments in the equity shares of other entities are measured at their fair values, with changes in fair value being taken directly to retained earnings. Surely unless all value changes are reported in the income statement the shareholders will have an incomplete picture of financial performance. In addition investments in redeemable preferred shares of other entities are measured at amortised cost. I don't understand the meaning of 'amortised cost' and would like an explanation please. It seems inconsistent to treat similar investments in different ways. Please explain this too. (9 marks)

3. The balance sheet of our entity shows a net liability that is the difference between the obligation to pay retirement benefits to our workforce and the value of the assets of their pension plan. I do not understand why these amounts are in our financial statements at all. Our entity pays contributions to the plan and then the plan pays the retirement benefits. All our contributions are up to date so why is there a liability in our books and why are we including the assets of a plan that is a separate legal entity? (7 marks)

Required:

Draft a reply that responds to the queries raised by the executive. Where relevant, you should refer to appropriate international financial reporting standards.

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

(25 marks)

DipIFR 06 Dec Questions

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Question 4 begins on page 8

4 The draft income statement of Kappa for its year ended 30 September 2006 is given below:

	$'000
Revenue	90,000
Cost of sales	(35,000)
Gross profit	55,000
Other income	7,000
Distribution costs	(9,000)
Administrative expenses	(15,000)
Finance costs	(10,000)
Profit before tax	28,000
Income tax expense	(7,000)
Profit for the year	21,000

The following information is relevant to the draft income statement:

1. At the year end the entity was in the process of defending a legal case brought against it for breach of copyright. The entity's lawyers provided the following estimates of the likely outcome of the case:
   – A 30% chance of defending the case successfully.
   – A 60% chance of being required to pay $3 million in damages.
   – A 10% chance of being required to pay $6 million in damages.
   The draft financial statements included a provision for $2·4 million (30% x nil + 60% x $3 million + 10% x $6 million). The charge in the income statement was made to administrative expenses.

2. During the period a development project that had been started on 1 April 2005 reached a stage where the likely outcome of the project was such that the expenditure qualified for recognition as an intangible asset in accordance with the criteria laid down in IAS 38 – *Intangible Assets*. This stage was reached on 31 March 2006. Details of relevant expenditure are as follows:
   – $2 million was incurred in the period 1 April to 30 September 2005 and charged to cost of sales in the previous period.
   – $1·5 million was incurred in the period 1 October 2005 to 31 March 2006.
   – $1 million was incurred in the period 1 April to 30 September 2006.
   The draft financial statements include an intangible asset of $4·5 million, with the $2 million charged as an expense in the previous year shown in the current year income statement as 'other income'.

3. On 1 April 2006 Kappa sold a piece of land to a bank for $14 million. Prior to the sale the land was included in the financial statements at a cost of $9 million. The gain on sale was included in other income. Kappa has an option to repurchase the land for $15·4 million on 31 March 2007 and the bank has an option to require Kappa to repurchase the land for $15·4 million on the same date.

4. When computing depreciation for the year ended 30 September 2006, Kappa reassessed the estimated useful economic lives of its property, plant and equipment. Of the depreciation provided for the period, $6 million related to additional depreciation that would have been provided in previous periods had the new estimated asset lives been used in those previous periods. In the draft financial statements this additional depreciation has been treated as a change in accounting policy and taken directly to equity. Normally depreciation is included in the income statement as part of cost of sales.

5. On 30 September 2006 Kappa owed an overseas supplier a foreign currency denominated amount of $6 million. Since the financial year end the dollar has weakened against the relevant foreign currency and at the date the draft financial statements were produced the amount payable had a dollar equivalent of $6·5 million. The draft financial statements included a payable of $6·5 million, with $500,000 being debited to the income statement as an administrative expense.

6. On 1 October 2005 Kappa purchased some land for $20 million with the intention of building a factory. Activities necessary to prepare the factory for use began on 1 December 2005 and were completed on 30 June 2006. The factory was gradually brought into use from 1 July 2006 and has just become fully operational. The building work was sub-contracted and the total building cost of $15 million was paid to the sub-contractors on 31 March 2006. Both payments were financed by a loan at a fixed interest rate of 9% per annum. The entity decided to

DipIFR 06 Dec Questions

capitalise the finance costs incurred and a total of \$2·475 million ((\$20 million x 9%) + (\$15 million x 9% x 6/12)) was added to the cost of property, plant and equipment, with a corresponding reduction in the finance cost taken to the income statement.

7. The entity pays income tax at a marginal rate of 25%. Any adjustments made to the income statement can be assumed to affect the income tax charge at this rate.

Required:

Redraft the income statement of Kappa to reflect any adjustments you consider necessary as a result of the information given in notes 1–7. In all cases you should explain the adjustments you make by referring to appropriate international financial reporting standards.

(25 marks)

DipIFR 06 Dec Questions

5 Omega is an entity that owns three properties. All three properties were purchased on 1 October 2004. Details of the purchase price and market values of the properties are as follows:

	Property 1	Property 2	Property 3
	$'000	$'000	$'000
Purchase price	15,000	10,000	12,000
Market value 30 September 2005	16,000	11,000	13,500
Market value 30 September 2006	17,000	9,000	14,500

Properties 1 and 2 are used by Omega as factories whilst property 3 is let to a non-related third party at a commercial rent. Omega does not depreciate any of the properties on the basis that they are valued at market values that are generally expected to increase over time.

Required:

(a) **Assess whether Omega's policy of non-depreciation of properties 1–3 is in accordance with international financial reporting standards.** (7 marks)

(b) **Show how the movements in the carrying amount of each property will be reflected in the financial statements of Omega for the years ended 30 September 2005 and 2006. You can assume that any relevant depreciation is immaterial.**
Where necessary you should justify your treatment with reference to appropriate international financial reporting standards. Where more than one treatment is permitted under international financial reporting standards you should show the impact of both treatments. (6 marks)

(c) On 1 October 2005 Omega brought into use an industrial site that had been constructed at a total cost of $50 million. Omega has the legal right to use the site for a 10 year period, at the end of which the site has to be returned to the legal owner in its original condition. The directors of Omega estimate that the cost of restoring the site on 30 September 2015 will be $15 million (in 2015 prices). The construction cost includes the right to use the site without further payment for the 10 year period. The rate to use in any discounting calculations is 8%. The present value of $1,000 receivable in 10 years when the cost of capital is 8% is $463.

Required:

Show the amounts that will appear in the balance sheet of Omega as at 30 September 2006 in respect of the site and the amounts that will appear in the income statement for the year ended 30 September 2006. You should state where in the balance sheet and where in the income statement the relevant amounts should be presented. Where necessary you should justify your treatment with reference to appropriate international financial reporting standards. (7 marks)

(d) On 1 October 2005 Omega granted 50 employees options to purchase 500 shares in the entity. The options vest on 1 October 2007 for those employees who remain employed by the entity until that date. The options allow the employees to purchase the shares for $10 per share. The market price of the shares was $10 on 1 October 2005 and $10·50 on 1 October 2006. The market value of the options was $2 on 1 October 2005 and $2·60 on 1 October 2006. On 1 October 2005 the directors estimated that 5% of the relevant employees would leave in each of the years ended 30 September 2006 and 2007 respectively. It turned out that 4% of the relevant employees left in the year ended 30 September 2006 and the directors now believe that a further 4% will leave in the year ended 30 September 2007.

Required:

Show the amounts that will appear in the balance sheet of Omega as at 30 September 2006 in respect of the share options and the amounts that will appear in the income statement for the year ended 30 September 2006.
You should state where in the balance sheet and where in the income statement the relevant amounts will be presented. Where necessary you should justify your treatment with reference to appropriate international financial reporting standards. (5 marks)

(25 marks)

End of Question Paper

DipIFR 06 Dec Questions

Diploma in International Financial Reporting

MONDAY 12 JUNE 2006

QUESTION PAPER

Time allowed **3 hours**

This paper is divided into two sections

Section A	This ONE question is compulsory and MUST be answered
Section B	THREE questions ONLY to be answered

Do not open this paper until instructed by the supervisor

This question paper must not be removed from the examination hall

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Section A – This ONE question is compulsory and MUST be attempted

1 Alpha holds investments in two other entities, Beta and Gamma. All three entities prepare financial statements to 31 March and the balance sheets of the three entities at 31 March 2006 were as follows:

	Alpha $'000	Beta $'000	Gamma $'000
Assets			
Non-current assets:			
Property, plant and equipment	90,000	80,000	80,000
Available for sale investments (Notes 1+2)	113,000	–	–
	203,000	80,000	80,000
Current assets:			
Inventories (Note 3)	30,000	28,000	25,000
Trade receivables (Note 4)	35,000	25,000	27,000
Other current assets	4,000	3,000	3,000
Cash and cash equivalents	10,000	9,000	8,000
	79,000	65,000	63,000
Total assets	**282,000**	**145,000**	**143,000**
Equity and Liabilities			
Share capital	100,000	60,000	60,000
Retained earnings	63,000	25,000	20,000
Total equity	163,000	85,000	80,000
Non-current liabilities:			
Long term borrowings	50,000	24,000	25,000
Deferred tax	36,000	13,000	14,000
Total non-current liabilities	86,000	37,000	39,000
Current liabilities:			
Trade and other payables (Note 4)	18,000	13,000	14,000
Short-term borrowings	6,000	4,000	4,000
Current tax payable	9,000	6,000	6,000
Total current liabilities	33,000	23,000	24,000
Total equity and liabilities	**282,000**	**145,000**	**143,000**

DipIFR 06 June Questions

Note 1 – purchase of shares in Beta

On 1 April 2004 Alpha purchased 45 million shares in Beta at an agreed price of $2·20 per share, paid in cash. This investment is carried in the balance sheet of Alpha at cost, as permitted by IAS 27 – *Consolidated and Separate Financial Statements*. At that date the balance sheet of Beta showed retained earnings of $15 million. The directors of Alpha carried out a fair value exercise on the net assets of Beta at that date as required by IFRS 3 – *Business Combinations*. The following matters arose out of the exercise:

(i) Property, plant and equipment comprised non-depreciable land with a carrying amount of $30 million and a market value of $50 million, plus plant and equipment with a carrying amount of $30 million and a market value of $39 million. The estimated future economic life of the plant and equipment at 1 April 2004 was three years. None of the property, plant and equipment held by Beta at 1 April 2004 had been disposed of by 31 March 2006.

(ii) Inventories were included at cost to Beta of $20 million. The equivalent selling price of the inventories was estimated at $25 million and a reasonable allowance for profit on the sale $4 million. Disposal costs were not considered to be material. All the inventories as at 1 April 2004 had been sold by 31 March 2006.

(iii) At 1 April 2004 Beta was subject to legal action from a customer. The customer was claiming damages of $3 million. The directors of Beta had made no provision for this amount because they considered the case could be successfully defended. However at 1 April 2004 they would have been prepared to make a payment of $600,000 to have the case dismissed. In the event the case was successfully defended and no payment was necessary.

(iv) At 1 April 2004 Beta had a brand name that it had protected by a legal process preventing any other business from using the name. This brand was not included in the individual balance sheet of Beta because the directors did not consider that it met the recognition criteria in IAS 38 – *Intangible Assets* – for internally developed intangible assets. The directors of Alpha considered that the brand name had a market value of $10 million at 1 April 2004 and that it would give Beta a competitive advantage for 10 years from that date.

Note 2 – purchase of shares in Gamma

On 1 June 2005 Alpha purchased 10 million shares in Gamma for $1·40 per share. This purchase was made with a view to further purchases in future. The current shareholding has not resulted in the directors of Alpha being able to exercise any influence over the operating and financial policies of Gamma. The fair value of a share in Gamma at 31 March 2006 was $1·60. The balance sheet of Alpha continues to carry this investment at cost.

Note 3 – inventories

The inventories of Beta at 31 March 2006 include components purchased from Alpha at a cost of $15 million. Alpha paid $12 million to produce the components.

Note 4 – trade receivables and payables

The trade receivables of Alpha included $5 million receivables from Beta in respect of the purchase of components (see Note 3). Beta paid this amount on 30 March 2006 but the cash was not received and recorded by Alpha until 2 April 2006. There were no other intra-group current account balances.

Note 5 – other information

(i) The share capital of all three entities comprises equity shares of $1. All equity shares carry one vote and no special controlling powers exist other than through the ownership of equity shares.

(ii) Despite owning a reasonably substantial number of equity shares in Gamma, Alpha does not have the power to appoint any representatives to the board of directors of Gamma.

(iii) The goodwill arising on acquisition of Beta has not suffered any impairment since 1 April 2004.

(iv) The fair value adjustments give rise to temporary differences. The rate of taxation to apply to temporary differences is 25%

Required:

(a) Prepare the consolidated balance sheet of Alpha at 31 March 2006. Your workings should include references to international financial reporting standards where appropriate. (21 marks)

(b) Explain the effect on your answer to (a) if the investment in Gamma gave Alpha representation on the board of directors of Gamma and the ability to participate in its policy making process. You do NOT need to prepare the consolidated balance sheet under this revised assumption. (4 marks)

(25 marks)

Section B – THREE questions ONLY to be attempted

2 Delta is an entity that prepares its financial statements to 31 March each year. The financial statements for the year ended 31 March 2006 are being prepared and you are provided with the following trial balance at that date:

	$'000	$'000
Revenue (Note 1)		215,000
Inventories at 1 April 2005 (Note 2)	30,000	
Raw material purchases	90,000	
Production costs (Note 3)	50,000	
Distribution costs (Note 3)	15,000	
Administration costs (Note 3)	30,000	
Property, plant and equipment:		
– at cost (Note 4)	100,000	
– accumulated depreciation at 31 March 2005 (Note 4)		30,000
Suspense account (Note 5)		13,000
Construction contact (Note 6)	12,000	
Interest paid on long-term borrowing	4,000	
Income tax account (Note 7)	1,000	
Deferred tax (Note 7)		7,000
Trade receivables	50,000	
Cash and cash equivalents	48,000	
Trade payables		15,000
Long-term borrowings (10% interest rate)		40,000
Equity share capital ($1 shares)		90,000
Dividend paid 31 December 2005	20,000	
Retained earnings at 31 March 2005		40,000
	450,000	450,000

Notes to the Trial Balance

Note 1 – revenue
Revenue includes a sale of goods on 1 March 2006 for $10 million. The goods cost Delta $5 million to manufacture. The terms of the sale gave Delta an option to repurchase the goods for $11 million on 30 April 2006. The buyer had an option to require Delta to repurchase the goods for $11 million on 30 April 2006.

Note 2 – inventories
On 31 March 2006 the inventories at Delta's premises was counted. The appropriate value of the inventories – measured in accordance with the principles of IAS 2 – *Inventories* – was $35 million.

Note 3 – production, distribution and administration costs
The amounts contained in the trial balance do not include depreciation of property, plant and equipment. Depreciation (including any gains or losses on sale of plant and equipment and other than that of the construction contract plant (Note 6)) should be allocated 70:10:20 between production, distribution and administration.

Note 4 – property, plant and equipment

	Cost	Accumulated depreciation at 31 March 2005
	$'000	$'000
Property	60,000	10,000
Plant and equipment	40,000	20,000
	100,000	30,000

(i) The depreciable element of the property has an allocated cost of $25 million and is being depreciated on a straight-line basis over 50 years.

DipIFR 06 June Questions

(ii) The plant and equipment is being depreciated on a straight-line basis over five years, with a full year's depreciation in the year of purchase and no depreciation in the year of disposal. None of the plant and equipment held at 31 March 2005 was fully depreciated at that date.
(iii) On 30 September 2005 Delta sold plant that cost $10 million on 1 September 2001 for $1 million. The proceeds of sale were included in a suspense account (see Note 5 below).

Note 5 – suspense account
This account consists of two amounts:
(i) The proceeds of sale of plant (see note 4 above).
(ii) The proceeds of issue on 1 April 2005 of a bond carrying a zero interest rate but redeemable at an amount of $16,105,100 on 31 March 2010. As an alternative to redemption, the bond-holders have the option to convert the bond into equity shares. Had the option not been available the bond-holders would have only been prepared to invest $10 million given their requirement for a 10% return on their investment.

Note 6 – construction contract
On 1 October 2005 Delta commenced work on a construction contract that had been signed on 15 September 2005. The contract was for a fixed price of $40 million. Delta purchased plant at a cost of $10 million for use on the contract. This plant will have no value when the contract is completed on 30 September 2006. Other costs incurred on the contract, together with estimated costs to complete, were as follows:

	Incurred to date	Estimated costs to complete
	$'000	$'000
Purchase of materials	8,000	4,000
Labour and other overheads	6,000	7,000

The costs incurred to date were all debited to the contract account. On 31 March 2006 the contract was certified as being 40% complete and the customer made a progress payment of $12 million. This payment was credited to the contract account. No other entries have been made in respect of this contract.

Note 7 – income tax
– On 30 September 2005 Delta made full and final payment of $8 million to discharge the income tax liability for the year ended 31 March 2005. The amount originally provided was $7 million.
– The estimated income tax liability for the year ended 31 March 2006 is $6 million.
– A further credit of $2 million is required to the deferred tax account.

Required:

(a) Prepare the income statement for Delta for the year ended 31 March 2006. (11 marks)

(b) Prepare the statement of changes in equity for Delta for the year ended 31 March 2006. (3 marks)

(c) Prepare the balance sheet for Delta as at 31 March 2006 (11 marks)

Notes to the income statement and balance sheet are not required. However, your workings should justify your treatment of items referred to in the trial balance and the notes with appropriate references to international financial reporting standards.

(25 marks)

DipIFR 06 June Questions

3 You are a qualified accountant who supervises a number of trainee accountants. Your company is a listed company located within the European Union that raises capital on a number of capital markets. The European Union has recently passed a regulation that requires listed companies to use international financial reporting standards (IFRSs) when preparing consolidated financial statements for publication. The regulation applies to accounting periods beginning on or after 1 January 2005. The financial statements for the year ended 31 March 2006 have just been published. One of your trainees has left you a memorandum that contains four questions relating to the financial statements.

(a) I have noticed that the 2006 financial statements have been prepared using IFRSs, whilst the 2005 statements were based on our own domestic standards. Why has this happened? Have our domestic standards become discredited? Why have the 2006 financial statements included reconciliations of the 2005 numbers between those originally presented and the equivalent numbers under IFRSs? Were the reconciliations optional or are they required in the financial statements of first time adopters of IFRSs? (8 marks)

(b) You will be aware that we acquired a new subsidiary during the previous accounting period. Following this acquisition the intangible assets that are shown in the consolidated balance sheet contain a number of items relating to this subsidiary:

(i) The value of customer lists.
(ii) The value of trademarks.
(iii) The value of an internet domain name.

These assets do not appear in the individual balance sheet of the subsidiary to which they relate so why are they in the consolidated balance sheet? (5 marks)

(c) The financial statements disclose that in the previous year a number of subsidiaries made errors in counting their inventories. These errors affected last year's closing inventories and their effect has been reported in the statement of changes in equity. The financial statements also disclose that in the current year a number of subsidiaries revised the estimated useful economic lives of their plant. The effect of the revision has all been included in the consolidated income statement. In order to be consistent with the treatment of the inventories error shouldn't the prior period effect of the change in estimate be shown in the statement of changes in equity? (5 marks)

(d) I remember that on 1 April 2005 the company issued options that allowed employees to purchase shares for $10 per share on 31 December 2005 provided they satisfied certain performance conditions in the nine-month period between 1 April 2005 and 31 December 2005. The market value of the shares on 1 April 2005 was only $10, although by 31 December 2005 the market value had risen to $12 and 200,000 options were exercised, generating $2 million. I do not understand why the 2006 financial statements, prepared in accordance with IFRSs, include a charge in the income statement income of $360,000 relating to these share options. This represents a charge of $1·80 per share but since our company hasn't paid anything why should there be a charge in the income statement at all? (7 marks)

Required:

Draft a reply that responds to the questions raised by your trainee. Where relevant, you should refer to appropriate international financial reporting standards.

The mark allocation is shown against each of the four questions above.

(25 marks)

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Question 4 begins on page 8.

DipIFR 06 June Questions

4 (a) Omega is an entity that requires a consistently high level of investment in property, plant and equipment. Historically the investment has always been financed either using equity or by arranging appropriate borrowings. More recently a greater proportion of the finance has been provided in the form of borrowing because conditions for a share issue have been unfavourable. This has led to Omega's borrowings increasing to such a level that the directors would be uncomfortable about the impact of further significant borrowings on the balance sheet. However, conditions for a share issue remain unfavourable, but the demand for additional investment in property, plant and equipment continues.

Your assistant has approached you with the suggestion that a future solution to this dilemma might be to lease property, plant and equipment rather than purchase it. This strategy, according to your assistant, would enable Omega to procure the additional property, plant and equipment it needs without additional borrowings that would have an unfavourable impact on the balance sheet.

Required:

Draft a reply that responds to the suggestion made by your assistant. Where relevant, you should refer to appropriate international financial reporting standards. Your answer should explain the way in which the characteristics of a lease determine its accounting treatment. (7 marks)

(b) Your requirements for capital investment in the next accounting period are set out below. In each case your assistant has identified an alternative leasing option for your consideration:

New fleet of vehicles
Omega needs a new fleet of vehicles for its sales staff. The new fleet would cost $800,000 to purchase outright and would have an expected useful economic life of four years from the date of purchase. As an alternative to outright purchase, Omega could lease the vehicles on a two-year lease for annual rentals of $180,000, payable monthly in arrears. At the end of two years the lease could be re-negotiated or the vehicles returned to the lessor. The lessor provides a full repair and maintenance service for the fleet of vehicles that is free of charge throughout the two-year lease period.

New production plant
Omega needs to re-fit one of its production plants with new machinery. The machinery would cost $2·4 million to buy and would have an expected useful economic life of six years. As an alternative to outright purchase the machines could be leased on a four-year lease with payments of $760,000 annually in arrears. At the end of the four-year period Omega has the option to continue to lease the machinery for a further two years for an annual rental of $1, payable in arrears. Omega is responsible for the repair and maintenance of the machinery throughout the primary and secondary rental period. At the end of six years the machinery is likely to have a negligible residual value.

Required:

Assuming the leasing option is taken up in both cases, compute all relevant amounts (excluding cash) that would appear in the income statement and the balance sheet for the first year of the lease. Assume in both cases that the leases commenced on the first day of the accounting period and that all payments in arrears have been made by the balance sheet date. Where relevant, you should refer to appropriate international financial reporting standards. Assume, where necessary, an annual finance cost of 10%. (12 marks)

DipIFR 06 June Questions

(c) Omega is likely to need to acquire at least one new property in the near future. A potential property has been identified which would cost $10 million to purchase outright. The purchase price of $10 million could be reasonably apportioned 50:50 between the land and the buildings. The buildings are estimated to have a useful economic life of 25 years. As an alternative to outright purchase, two leasing options exist:

(i) To lease the property on a 25-year lease. At the end of the lease term the title to the property would pass to Omega

(ii) To lease the property on a 25-year lease but at a lower rental than in (i) above). At the end of the 25-year period the title to the property would remain with the lessor and Omega would have to vacate it.

Required:

Assuming Omega wants to lease the property rather than purchase it outright, EXPLAIN (<u>without</u> performing any detailed calculations) how the lease would be treated in the financial statements of Omega under <u>both</u> options. Where relevant, you should refer to appropriate international financial reporting standards. (6 marks)

(25 marks)

DipIFR 06 June Questions

5 Epsilon prepares consolidated financial statements under international financial reporting standards. Your assistant has prepared the first draft of the financial statements for the year ended 31 March 2006 but there are a number of transactions about which she is unsure. These are listed below:

(a) Transaction 1

(i) On 1 April 2005 Epsilon acquired a new subsidiary, Kappa, purchasing all 100 million shares of Kappa. The terms of the sale agreement included the exchange of three shares in Epsilon for every two shares acquired in Kappa. On 1 April 2005 the market value of a share in Epsilon was $10 and the market value of a share in Kappa $13·50.

(ii) The terms of the share purchase included the payment of an additional $1·21 per share acquired provided the profits of Kappa for the two years ending 31 March 2007 exceeded a target figure. Current estimates are that it is 75% probable that the management of Kappa will achieve this target.

(iii) Legal and professional fees associated with the acquisition of Kappa shares were $1,200,000, including $200,000 relating to the cost of issuing shares. The senior management of Epsilon estimate that the cost of their time that can be fairly allocated to the acquisition is $100,000. This figure of $100,000 is not included in the legal and professional fees of $1,200,000 mentioned above.

(iv) The individual balance sheet of Kappa at 1 April 2005 comprised net assets that had a fair value at that date of $1,200 million. Additionally Epsilon considered Kappa possessed certain intangible assets that were not recognised in its individual balance sheet:

– Customer relationships had a reliable estimate of value of $100 million. This value has been derived from the sale of customer databases in the past.

– Employee expertise had a reliable estimate of value of $80 million.

(v) The directors of Epsilon were unsure how long the goodwill on acquisition of Kappa would last but they thought that 10 years might be a prudent estimate of its useful economic life. However, they considered that the goodwill had not suffered any impairment up to 31 March 2006.

(vi) The annual discount rate to use in any relevant calculations is 10%.

Required:

Compute the goodwill on consolidation of Kappa that will appear in the consolidated balance sheet of Epsilon at 31 March 2006. You should make appropriate references to international financial reporting standards. (9 marks)

(b) Transaction 2

On 1 April 2005 Epsilon issued convertible loan notes for total proceeds of $500 million. The notes were repayable at $500 million on 31 March 2009 or convertible into equity shares on that date. Interest of $40 million was payable annually in arrears. The finance cost of a non-convertible loan at 1 April 2005 would have been 10% per annum.

Required:

Show how the convertible loan note would be presented in the balance sheet of Epsilon at 31 March 2006. You should make appropriate references to international financial reporting standards. (8 marks)

DipIFR 06 June Questions

(c) Transaction 3

Epsilon is planning a major equity investment in Europe towards the end of 2006. Latest indications are that this investment will cost 100 million euros and that the funds will be required on 30 November 2006. However, at the balance sheet date Epsilon had not entered into a contractual commitment to purchase the shares.

Epsilon wanted to provide a measure of certainty regarding the cost of the investment in $s. Therefore, on 31 January 2006 the entity entered into a contract to purchase 100 million euros for $140 million, with a delivery date of 30 November 2006. On 31 March 2006, the rate of exchange was such that this contract was a favourable one for Epsilon and had a fair value of $1,500,000.

Required:

Show how the equity investment and currency contract will affect the consolidated balance sheet of Epsilon as at 31 March 2006. Indicate how any changes in carrying value will be reported in the statement of changes in equity and/or income statement for the year ended 31 March 2006. You should make appropriate references to international financial reporting standards. (8 marks)

(25 marks)

End of Question Paper

Diploma in International Financial Reporting

Thursday 6 December 2007

Dip IFR

Time allowed
Reading and planning: 15 minutes
Writing: 3 hours

This paper is divided into two sections:

Section A – This ONE question is compulsory and MUST be attempted

Section B – THREE questions ONLY to be attempted

Do NOT open this paper until instructed by the supervisor.
During reading and planning time only the question paper may be annotated. You must NOT write in your answer booklet until instructed by the supervisor.
This question paper must not be removed from the examination hall.

The Association of Chartered Certified Accountants

Section A – This ONE question is compulsory and MUST be attempted

1 Alpha holds investments in two other entities, Beta and Gamma. The balance sheets of the three entities at 30 September 2007 were as follows:

	Alpha	Beta	Gamma
	$'000	$'000	$'000
Assets			
Non-current assets:			
Property, plant and equipment (Notes 1 & 2)	132,000	100,000	90,000
Investments (Note 1)	139,000	Nil	Nil
	271,000	100,000	90,000
Current assets:			
Inventories (Note 3)	40,000	34,000	32,000
Trade receivables (Note 4)	40,000	32,000	30,000
Financial assets (Note 5)	10,000	Nil	Nil
Cash and cash equivalents	9,000	11,000	8,000
	99,000	77,000	70,000
Total assets	370,000	177,000	160,000
Equity and Liabilities			
Equity			
Share capital ($1 shares)	100,000	60,000	70,000
Retained earnings	138,000	48,000	29,000
Total equity	238,000	108,000	99,000
Non-current liabilities:			
Long-term borrowings	60,000	30,000	25,000
Deferred tax	30,000	12,000	10,000
Total non-current liabilities	90,000	42,000	35,000
Current liabilities:			
Trade and other payables (Note 4)	35,000	20,000	20,000
Short-term borrowings	7,000	7,000	6,000
Total current liabilities	42,000	27,000	26,000
Total equity and liabilities	370,000	177,000	160,000

Note 1 – investments

Investment in Beta:
Alpha subscribed for 48 million shares in Beta at par on the date of Beta's incorporation on 1 October 1999. This investment is shown at original cost.

Investment in Gamma:
On 1 April 2007 Alpha purchased 49 million shares in Gamma for a cash payment of $91 million. This investment is also shown at original cost.

The profit of Gamma for the year ended 30 September 2007 was $8 million. Gamma did not pay or declare any dividends in the period.

The directors of Alpha carried out a fair value exercise to measure the identifiable assets and liabilities of Gamma at 1 April 2007. The following matters emerged:

A property having a carrying value of $20 million had an estimated market value of $30 million (including non-depreciable land of $15 million). The estimated future economic life of the depreciable element at 1 April 2007 was 30 years. In the year ended 30 September 2007 Gamma charged depreciation of $320,000 on this property.

DipIFR 07 Dec Questions

Plant and equipment having a carrying value of $60 million had an estimated market value of $65 million. The estimated future economic life of the plant at 1 April 2007 was five years.

Inventory having a carrying value of $10 million had an estimated fair value of $12 million. All of this inventory was sold prior to 30 September 2007.

The fair value adjustments will be regarded as temporary differences for the purposes of computing deferred tax.

Note 2 – sale of plant to Beta

On 1 October 2006 Alpha purchased an item of plant for $4 million and immediately sold it to Beta for $4·4 million. The estimated useful economic life of the plant is four years from 1 October 2006.

Note 3 – intra-group sale of inventories

The inventories of Beta and Gamma at 30 September 2007 included components purchased from Alpha during the year at a cost of $25 million to Beta and $15 million to Gamma. Alpha supplied these components at cost plus a mark up of 25%. All the supplies were made after 1 April 2007.

Note 4 – trade receivables and payables

The trade receivables of Alpha included $6 million receivable from Beta and $5 million receivable from Gamma in respect of the purchase of components (see Note 3). The trade payables of Beta and Gamma include an equivalent amount payable to Alpha.

Note 5 – financial assets

During the period Alpha made a temporary investment of $10 million in listed securities and designated the investments as fair value through profit and loss. The market value of the portfolio (none of which was sold before the year end) was $9·5 million.

Note 6 – other information

The goodwill arising on acquisition of Gamma has not suffered any impairment since 1 April 2007.

The rate of tax to apply to temporary differences is 25%. You can ignore the temporary differences caused by any adjustments for unrealised profits.

Required:

Prepare the consolidated balance sheet of Alpha at 30 September 2007.

(25 marks)

DipIFR 07 Dec Questions

Section B – THREE questions ONLY to be attempted

2 Delta's financial statements for the year ended 30 September 2007 are being prepared and you are provided with the following trial balance at that date:

	$'000	$'000
Revenue (Note 1)		325,000
Inventories at 1 October 2006	50,000	
Raw material purchases	160,000	
Production costs	40,000	
Distribution costs	15,000	
Administrative expenses	25,000	
Property, plant and equipment:		
– at cost (Note 3)	160,000	
– accumulated depreciation at 30 September 2006 (Note 3)		35,000
Suspense account (Note 4)	10,000	
Interest paid on long-term borrowing	11,000	
Income tax account (Note 5)		500
Deferred tax (Note 5)		5,000
Trade receivables	125,000	
Cash and cash equivalents	54,500	
Trade payables		55,000
Long-term borrowings at 10% interest rate		110,000
Equity share capital ($1 shares)		100,000
Equity dividend paid 30 September 2007	25,000	
Retained earnings at 30 September 2006		45,000
	675,500	675,500

Notes to the trial balance

Note 1 – Revenue
On 20 September 2007 Delta sold goods that cost Delta $6 million to manufacture at a gross profit margin of 20%. Delta recognised the sale as revenue when the goods were sent to the customer. The goods were supplied on a sale or return basis, with a right to return up to and including 31 January 2008. The customer had returned 50% of the goods by 30 November 2007. It is uncertain as to how many of the remaining goods will be returned prior to 31 January 2008.

Note 2 – Inventories
On 30 September 2007 the value of the inventories at Delta's premises was $55 million.

Note 3 – Property, plant and equipment

	Cost	Accumulated depreciation at 30 September 2006
	$'000	$'000
Property	80,000	20,000
Plant and equipment	80,000	15,000
	160,000	35,000

(i) Depreciation of all property, plant and equipment should be charged to cost of sales.

(ii) The depreciable element of the property has an allocated cost of $40 million and is being depreciated on a straight-line basis over 50 years.

(iii) On 1 October 2006 the property was revalued to its market value of $90 million. It was estimated that $56 million of this value was attributable to the depreciable element. This revaluation has not yet been recorded in the accounting records of Delta.

(iv) No change in the estimated useful economic life of the depreciable element was anticipated at the date of the revaluation. The directors of Delta wish to make an annual transfer of excess depreciation on revalued assets from the revaluation reserve to retained earnings.

DipIFR 07 Dec Questions

(v) The plant and equipment is being depreciated on a straight-line basis over five years, with a full year's depreciation in the year of purchase and no depreciation in the year of disposal. None of the plant and equipment held at 30 September 2007 was fully depreciated at that date. No disposal of property, plant and equipment occurred in the period.

Note 4 – Suspense account

On 1 October 2006 Delta began to lease a number of specialised production machines under a finance lease. The lease was of four years duration and Delta was required to pay a deposit of $10 million on 1 October 2006 followed by three further payments of $5 million each on 1 October 2007, 2008 and 2009. The rate of interest implicit in the lease is 8% and the fair value of the leased assets at 1 October 2006 was approximately $22·9 million. The only entry made by Delta was to debit the deposit paid to the suspense account.

Note 5 – Income tax

(i) On 30 June 2007 Delta made full and final payment to discharge the income tax liability for the year ended 30 September 2006. The balance on the income tax account in the trial balance is the residue after making that payment.

(ii) The estimated income tax liability for the year ended 30 September 2007 is $10 million.

(iii) A credit of $2·4 million is required to the deferred tax account. This does not include any deferred tax that needs to be recognised on the property revaluation (see note 3 above).

(iv) Delta pays income tax at a rate of 25% on net taxable gains.

Required:

(a) Prepare the income statement for Delta for the year ended 30 September 2007. (9 marks)

(b) Prepare the statement of changes in equity for Delta for the year ended 30 September 2007. (5 marks)

(c) Prepare the balance sheet for Delta as at 30 September 2007. (11 marks)

Note: notes to the income statements and balance sheet are not required.

(25 marks)

DipIFR 07 Dec Questions

3 Epsilon is a listed entity. You are the financial controller of the entity and its consolidated financial statements for the year ended 30 September 2007 are being prepared. Your assistant, who has prepared the first draft of the statements, is unsure about the correct treatment of a number of transactions and has asked for your advice. Details of the transactions are given below:

Transaction (a)

On 1 October 2006 Epsilon signed a contract to construct a dam at a fixed price of $50 million. The contract has a scheduled completion date of 30 September 2008. However, if the contract is completed satisfactorily on or before 30 June 2008 Epsilon becomes entitled to a bonus of $5 million. If the contract is completed later than 31 December 2008, then Epsilon will forfeit $15 million of the fixed price and only receive $35 million. Latest estimates regarding completion dates are as follows:

Prior to 1 July 2008 – 20% probability.
1 July 2008 to 31 December 2008 – 70% probability.
After 31 December 2008 – 10% probability.

Epsilon incurred costs of $28 million on the contract up to 30 September 2007 and expects to incur further costs of $12 million to complete the contract. Your assistant has shown a net balance of $13 million in inventories on the balance sheet. This is the difference between the costs incurred to date ($28 million), the loss of $5 million ($35 million – ($28 million + $12 million)) that would arise on the contract if it was completed after 31 December 2008, and a progress payment of $10 million made by the customer before 30 September 2007. The loss of $5 million has been charged to the income statement and justified by the assistant on the grounds of prudence. An independent expert has recently certified that at 30 September 2007 the construction of the dam was 45% complete. The assistant proposes deferring recognition of any revenue until the contract is completed. (8 marks)

Transaction (b)

On 1 October 2006 Epsilon opened a new factory in an area designated by the government as an economic development area. On that day the government provided Epsilon with a grant of $20 million to assist them in the development of the factory. This grant was in two parts:

(i) $12 million of the grant related to the construction of a large factory at a cost of $60 million. The land was leased so the whole of the $60 million is depreciable over the estimated 30 year useful life of the factory.

(ii) The remaining $8 million was received subject to keeping at least 200 employees working at the factory for a period of at least five years. If the number drops below 200 at any time in any financial year in this five year period then 20% of the grant is repayable in that year. From 1 October 2006 250 workers were employed at the factory and estimates are that this number is likely to increase over the next four years.

Your assistant has recognised the $12 million received in respect of the factory as a credit to the income statement in the current year, on the basis that the factory has been constructed and brought into use. He has not recognised any of the $8 million employment grant on the basis that this is potentially repayable. He has charged $2 million in depreciation to the income statement. (10 marks)

Transaction (c)

On 1 October 2006 Epsilon purchased an aircraft for use by its executives on business trips. The purchase price paid was $15 million plus recoverable sales taxes of $1·5 million. The expected useful economic life of the aircraft is 15 years. Every five years the aircraft needs a major overhaul in order to renew its safety certificate. The current cost of such overhauls is $1·8 million. Your assistant has included $16·5 million ($15 million + $1·5 million) in property, plant and equipment and has charged depreciation of $1·1 million ($16·5 million x 1/15) to the income statement. He has charged $360,000 ($1·8 million x 1/5) to the income statement in respect of the overhaul, intending to build up a provision of $1·8 million over the next five years in order to cover the cost of the first overhaul. (7 marks)

Required:

Evaluate the proposed accounting treatments and (where incorrect) explain the appropriate accounting treatment (preparing relevant calculations where necessary) of the three transactions in the financial statements for the year ended 30 September 2007.

Note: the mark allocation is shown against each of the transactions above.

(25 marks)

DipIFR 07 Dec Questions

4 **(a)** As the worldwide financial community gets more and more sophisticated the nature of financial instruments is changing rapidly. Entities can use financial instruments to radically alter their risk profile and users are entitled to information about the impact of financial instruments on the business.

Required:

(i) **Define a financial asset, a financial liability and an equity instrument in accordance with IAS 32 – *Financial instruments: presentation*.** (4 marks)

(ii) **Explain where the following financial instruments would be presented in the balance sheet:**

1 **A portfolio of listed investments held for trading.**
2 **An investment in the shares of a supplier that is being held for the long term.**
3 **A loan made to the company that is repayable in equal instalments over the next five years.**
4 **Preference shares issued by the company that require payment of a dividend each year and are redeemable at the option of the investor.** (5 marks)

(iii) **Describe the categories into which IAS 39 – *Financial instruments: recognition and measurement* – requires financial assets and financial liabilities to be classified. For each category explain how the financial assets and liabilities should be measured in the balance sheet. Where the financial assets or liabilities are measured at fair value, your explanation should include the way in which changes in fair value are recognised in the performance statements (income statement and statement of changes in equity).** (9 marks)

(b) Kappa is a listed entity whose year end date is 30 September 2007. On 1 October 2006 Kappa issued a $6 million convertible loan note. The quoted rate of interest on the loan note was 2% per annum, payable on 30 September in arrears. The loan note was repayable at an amount of $7 million on 30 September 2009. As an alternative to repayment the lender may choose to receive 1 million shares in Kappa (having a nominal value of $1 each).

The required rate of return for providers of this type of loan finance at 1 October 2006 was 10% per annum.

Required:

Prepare extracts that show how the loan would be presented in the financial statements of Kappa for the year ended 30 September 2007. (7 marks)

(25 marks)

DipIFR 07 Dec Questions

5 Omega prepares financial statements using International Financial Reporting Standards. In the year ended 30 September 2007 the following transactions occurred:

(a) On 1 October 2006 Omega acquired a new subsidiary, Sigma, purchasing all 150 million shares of Sigma. The terms of the sale agreement included the exchange of four shares in Omega for every three shares acquired in Sigma. On 1 October 2006 the market value of a share in Omega was $10 and the market value of a share in Sigma $12·00.

The terms of the share purchase included the issue of one additional share in Omega for every five acquired Sigma if the profits of Sigma for the two years ending 30 September 2008 exceeded a target figure. Current estimates are that it is 80% probable that the management of Sigma will achieve this target.

Legal and professional fees associated with the acquisition of Sigma shares were $1,200,000, including $200,000 relating to the cost of issuing shares. The senior management of Omega estimate that the cost of their time that can be fairly allocated to the acquisition is $200,000. This figure of $200,000 is not included in the legal and professional fees of $1,200,000 mentioned above.

The individual balance sheet of Sigma at 1 October 2006 comprised net assets that had a fair value at that date of $1,200 million. Additionally Omega considered Sigma possessed certain intangible assets that were not recognised in its individual balance sheet:

Customer relationships – reliable estimate of value $100 million. This value has been derived from the sale of customer databases in the past.

An in process research and development project that had not been recognised by Sigma since the necessary conditions laid down in International Financial Reporting Standards for capitalisation were only just satisfied at 30 September 2007. However, the fair value of the whole project (including the research phase) is estimated at $50 million.

Employee expertise – directors' estimate of value $80 million.

The market value of a share in Omega on 30 September 2007 was $11.

Required:

Compute the goodwill on consolidation of Sigma that will appear in the consolidated balance sheet of Omega at 30 September 2007. (10 marks)

(b) On 1 October 2005 Omega granted 1,000 employees options to purchase 5,000 shares each in the entity. The options vest on 1 October 2008 for those employees who remain employed by the entity until that date. The options allow the employees to purchase the shares for $9 per share. The market price of the shares and the fair values of the share options (estimated using an appropriate option pricing model) varied as follows:

Date	Market price of share	Fair value of option
1 October 2005	$9	$2
1 October 2006	$10	$2·50
1 October 2007	$11	$2·70

When preparing the financial statements for the year ended 30 September 2006 the directors estimated that 50 of the relevant employees would leave in each of the years ended 30 September 2006, 2007 and 2008. 50 of the relevant employees did leave in both of the years ended 30 September 2006 and 2007. However, the directors now believe that no further relevant employees will leave in the year ended 30 September 2008.

Omega is entitled to a tax deduction in respect of the options when they are exercised based on their intrinsic value at that date. The intrinsic value of a share option at a particular date is the difference between the exercise price of the option and the market value of the share at that date. The rate of corporate income tax in the jurisdiction in which Omega operates is 25%.

DipIFR 07 Dec Questions

Required:

Prepare extracts that show the amounts that will appear in the balance sheet of Omega as at 30 September 2007 in respect of the share options and the amounts that will appear in the income statement for the year ended 30 September 2007. You should state where in the balance sheet and where in the income statement the relevant amounts will be presented. (7 marks)

(c) On 31 July 2007 Omega decided to dispose of a 100% owned subsidiary Theta. The business activities of Theta are substantially different from those of the rest of the group. The net assets of Theta at 31 July 2007 were included in the consolidated financial statements of Omega at a net carrying amount of $200 million, made up as follows:

	$m
Unimpaired goodwill	40
Other assets	260
Liabilities	(100)
	200

On 31 July, Omega immediately began to seek a buyer and initial expectations were that the sale price (net of incremental selling costs) would be $170 million. None of the identifiable assets of Theta had suffered obvious impairment at 31 July. The carrying value of the identifiable net assets of Theta in the consolidated balance sheet at 30 September 2007 was approximately the same as their carrying amount on 31 July 2007. The latest position is that negotiations are at a relatively advanced stage with a buyer who is expected to pay $170 million (net of selling costs). Completion of the transaction is expected in early 2008.

Required:

Explain how the prospective sale of Theta will affect the consolidated financial statements of Omega for the year ended 30 September 2007 (preparing relevant calculations where necessary). (8 marks)

(25 marks)

End of Question Paper

Diploma in International Financial Reporting

MONDAY 11 JUNE 2007

QUESTION PAPER

Time allowed **3 hours**

This paper is divided into two sections

Section A	This ONE question is compulsory and MUST be answered
Section B	THREE questions ONLY to be answered

Do not open this paper until instructed by the supervisor

This question paper must not be removed from the examination hall

The Association of Chartered Certified Accountants

Section A – This ONE question is compulsory and MUST be attempted

1 Alpha holds investments in two other entities, Beta and Gamma. All three entities prepare financial statements to 31 March and the balance sheets of the three entities at 31 March 2007 were as follows:

	Alpha $'000	Beta $'000	Gamma $'000
Assets			
Non-current assets:			
Property, plant and equipment	125,000	85,000	75,000
Investments (Note 2)	32,000	—	—
	157,000	85,000	75,000
Current assets:			
Inventories (Note 3)	33,000	30,000	28,000
Trade receivables (Note 4)	43,000	30,000	31,000
Cash and cash equivalents	11,000	10,000	9,000
	87,000	70,000	68,000
Total assets	**244,000**	**155,000**	**143,000**
Equity and liabilities			
Equity			
Share capital ($1 shares)	70,000	50,000	50,000
Retained earnings	55,000	44,000	28,000
Total equity	125,000	94,000	78,000
Non-current liabilities:			
Long term borrowings	50,000	25,000	22,000
Deferred tax	35,000	12,000	17,000
Total non-current liabilities	85,000	37,000	39,000
Current liabilities:			
Trade and other payables (Note 4)	25,000	17,000	20,000
Current tax payable	9,000	7,000	6,000
Total current liabilities	34,000	24,000	26,000
Total equity and liabilities	**244,000**	**155,000**	**143,000**

DipIFR 07 June Questions

Note 1 – purchase of shares in Beta

On 1 April 2006 Alpha purchased 40 million shares in Beta by issuing one share in Alpha for every two shares purchased in Beta. This share issue has not been recorded in the books of Alpha.

The quoted price of an Alpha share at 1 April 2006 was $6 and the quoted price of a Beta share at the same date was $2·40. Alpha incurred incremental legal and professional costs of $2 million in connection with the acquisition, of which $800,000 related to the cost of issuing its shares. These acquisition costs have been charged as an expense in the income statement of Alpha for the year ended 31 March 2007.

The retained earnings of Beta as shown in its balance sheet at 31 March 2006 were $35 million. The directors of Alpha carried out a fair value exercise on the net assets of Beta at that date. The following matters arose out of the exercise:

(i) Property, plant and equipment comprised non-depreciable land with a carrying amount of $50 million and a market value of $60 million, plus plant and equipment with a carrying amount of $30 million and a market value of $38 million. The estimated future economic life of the plant and equipment at 1 April 2006 was four years (straight line depreciation). None of the property, plant and equipment held by Beta at 1 April 2006 had been disposed of by 31 March 2007.

(ii) At 1 April 2006 Beta was engaged in legal action against a supplier in respect of damages caused by the supply of faulty products. Beta was claiming damages of $5 million. In the middle of March 2006 the customer had offered an out of court settlement of $3 million and Beta's lawyers advised that this was a fair offer given the likelihood of success in court. However Beta refused the offer, took the case to court, and subsequently won the case. The directors of Beta had not recognised any receivable in respect of the case in the balance sheet at 31 March 2006 because the claim was a contingent asset. The directors of Alpha considered that the fair value of the contingent asset at 1 April 2006 was $3 million.

(iii) At 1 April 2006 Beta had a long standing portfolio of loyal customers that regularly ordered goods and services from Beta. In addition, the workforce of Beta was highly trained and the expertise of the workforce was seen by the directors as conferring significant competitive advantage to Beta. The customer relationships and the expertise of the workforce were not included in the balance sheet of Beta at 31 March 2006 because the directors did not consider that they met the recognition criteria in IAS 38 – *Intangible Assets* – for internally developed intangible assets. The directors of Alpha considered that the customer relationships had a market value of $20 million at 1 April 2006 and that based on the life cycle of the existing products, the existing customers would continue to order goods and services from Beta for at least five years from that date. They estimated that the fair value of the competitive advantage conferred by the workforce was $15 million at 1 April 2006 and that the average period to retirement for a typical employee was twenty years.

(iv) The financial director of Alpha has stated that the fair value adjustments will create temporary differences for deferred tax purposes.

Note 2 – purchase of shares in Gamma

On 1 April 2005 Alpha purchased 20 million shares in Gamma for a cash payment of $1·60 per share. The retained earnings of Gamma were $15 million at 1 April 2005. This shareholding has resulted in the directors of Alpha being able to exercise a significant influence over the operating and financial policies of Gamma. The fair value of the net assets of Gamma at 1 April 2005 was equal to their carrying amounts in Gamma's balance sheet.

Note 3 – inventories

The inventories of Beta and Gamma at 31 March 2007 included components purchased from Alpha during the year at a cost of $20 million to Beta and $16 million to Gamma. Alpha supplied these components at cost plus a mark up of 25%.

Note 4 – trade receivables and payables

The trade receivables of Alpha included $5 million receivable from Beta and $4 million receivable from Gamma in respect of the purchase of components (see Note 3). The trade payables of Beta and Gamma include an equivalent amount payable to Alpha.

DipIFR 07 June Questions

Note 5 – other information

(i) Neither the goodwill arising on acquisition of Beta nor the investment in Gamma has suffered any impairment since the dates of investment by Alpha in these entities.

(ii) The rate of tax to apply to temporary differences is 25%.

Required:

(a) Prepare the consolidated balance sheet of Alpha at 31 March 2007. (21 marks)

(b) Explain the effect on your answer to (a) if the acquisition agreement with the former shareholders of Beta provided for an additional cash payment of 50 cents per share acquired. The additional amount, payable on 31 March 2008, is contingent on the profits of Beta exceeding a given level in the two years ending 31 March 2008.

Note: you do NOT need to prepare the consolidated balance sheet under this revised assumption or perform any detailed numerical calculations. (4 marks)

(25 marks)

DipIFR 07 June Questions

Section B – THREE questions ONLY to be attempted

2 Delta is an entity that prepares its financial statements to 31 March each year. The financial statements for the year ended 31 March 2007 are being prepared and you are provided with the following trial balance at that date:

	$'000	$'000
Revenue (Note 1)		265,000
Inventories at 1 April 2006	35,000	
Raw material purchases	107,000	
Production costs	50,000	
Distribution costs	10,000	
Administration costs	20,000	
Property, plant and equipment:		
– at cost (Note 3)	140,000	
– accumulated depreciation at 31 March 2006 (Note 3)		33,000
Suspense account (Note 4)		15,000
Lease rentals (Note 5)	25,000	
Interest paid on long-term borrowing	5,000	
Income tax account (Note 6)	1,000	
Deferred tax (Note 6)		9,000
Trade receivables	86,000	
Cash and cash equivalents	48,000	
Trade payables		35,000
Long-term borrowings (10% interest rate)		50,000
Equity share capital ($1 shares)		100,000
Dividend paid 31 December 2006	20,000	
Retained earnings at 31 March 2006		40,000
	547,000	547,000

Notes to the Trial Balance

Note 1 – Revenue
Revenue includes a sale of goods on 30 September 2006 for $30 million. The terms of the sale include the provision by Delta of after sales service for a period of two years. The cost to Delta of the after sales service is expected to be $2 million per annum and a reasonable profit margin on the service would be 20%.

Note 2 – Inventories
On 31 March 2007 the value of Delta's inventories was $40 million.

Note 3 – Property, plant and equipment

	Cost $'000	Accumulated depreciation at 31 March 2006 $'000
Property	60,000	15,000
Plant and equipment	80,000	18,000
	140,000	33,000

(i) The amounts contained in the trial balance do not include depreciation of property, plant and equipment for the year ended 31 March 2007. Depreciation of all property, plant and equipment should be allocated 80:10:10 between production, distribution and administration.

(ii) The depreciable element of the property has an allocated cost of $25 million and is being depreciated on a straight-line basis over 50 years.

(iii) On 1 April 2006 the property was revalued to its market value of $120 million. It was estimated that $40 million of this value is attributable to the depreciable element. This revaluation has not yet been recorded in the accounting records of Delta. No change in the estimated useful economic life of the depreciable element is anticipated.

(iv) The plant and equipment is being depreciated on a straight-line basis over five years, with a full year's depreciation in the year of purchase and no depreciation in the year of disposal. None of the plant and equipment held at 31 March 2007 was fully depreciated at that date. No disposal of property, plant and equipment occurred in the period.

Note 4 – suspense account
On 1 April 2006 Delta issued 15 million $1 preferred shares at par. The proceeds were credited to a suspense account. The shareholders will not receive a dividend but the shares are redeemable on 31 March 2011 for $1·61 per share. This is equivalent to an annual return of 10% for the shareholders.

Note 5 – lease rentals
On 1 April 2006 Delta began to use a new specialised network of machines. The network was leased on a five year lease with annual payments of $25 million payable in advance. The network would have cost $108 million to purchase outright and the lessor was seeking a return of 8% per annum on this investment.

The network is expected to have only a negligible value at the end of the five year period and Delta has the option to purchase the network at that time for a nominal sum of $100.

Note 6 – income tax
(i) On 30 September 2006 Delta made full and final payment of $7·5 million to discharge the income tax liability for the year ended 31 March 2006. The amount originally provided was $6·5 million.

(ii) The estimated income tax liability for the year ended 31 March 2007 is $8 million.

(iii) A credit of $3 million is required to the deferred tax account. This does not include any deferred tax that needs to be recognised on the property revaluation (see note 3 above).

(iv) Delta pays income tax at a rate of 30% on net taxable gains.

Note 7 – other information
The directors of Delta do not wish to make an annual transfer of excess depreciation on revalued assets from the revaluation reserve to retained earnings.

Required:

(a) Prepare the income statement for Delta for the year ended 31 March 2007. (11 marks)

(b) Prepare the statement of changes in equity for Delta for the year ended 31 March 2007. (3 marks)

(c) Prepare the balance sheet for Delta as at 31 March 2007 (11 marks)

Note: notes to the income statement and balance sheet are not required. However your workings should justify your treatment of items referred to in the trial balance and the notes.

(25 marks)

DipIFR 07 June Questions

3 Epsilon is a listed entity. You are the financial controller of the entity and its consolidated financial statements for the year ended 31 March 2007 are being prepared. Your assistant, who has prepared the first draft of the statements, is unsure about the correct treatment of a number of transactions and has asked for your advice. Details of the transactions are given below:

Transaction (a)

Epsilon has an 80% subsidiary that it acquired on 31 March 2005 for a cash payment of $80 million. The fair value exercise revealed that the fair value of the identifiable net assets of the subsidiary at that date was $90 million. The fair value adjustments were incorporated into the individual financial statements of the subsidiary at 31 March 2005. The summarised balance sheet of the subsidiary at 31 March 2007 showed the following balances:

	$'000
Non-current assets	100,000
Current assets	30,000
	130,000
Equity	85,000
Non-current liabilities	35,000
Current liabilities	10,000
	130,000

Your assistant is aware that the goodwill of the subsidiary had not suffered any impairment loss when it was tested for impairment at 31 March 2006. However he is unsure what this means. He also provides you with the information that the value in use of the non-current assets of the subsidiary (a single cash-generating unit) is $97 million, and that one of the non-current assets (included in the above balance sheet at a carrying value of $4 million) has been destroyed and is in fact worthless. (10 marks)

Transaction (b)

On 1 April 2006 Epsilon began to lease a property on a 100 year lease. The property had a market value of $10 million at the start of the lease. The lease provides for annual rentals of $250,000 payable on 31 March each year. Because the lease terms do not provide for title to the property to pass to Epsilon at the end of the lease, nor is there any right to purchase the property at a favourable price at that time, your assistant has concluded that the lease is an operating lease. Therefore in the draft financial statements your assistant has taken $250,000 to the income statement. (10 marks)

Transaction (c)

In previous periods Epsilon had included relevant borrowing costs as part of the carrying value of property, plant and equipment. On 31 March 2006 property, plant and equipment included $500,000 relating to capitalised finance costs. During the current period the directors decided to change their treatment of such costs and charge them as an expense when incurred. In the draft financial statements your assistant has charged $500,000 as an expense in the income statement. However he has questioned whether changing the treatment of the finance costs is appropriate since the financial statements ought to be comparable from one year to another. (5 marks)

Required:

Explain to your assistant the appropriate accounting treatment of the three transactions in the financial statements for the year ended 31 March 2007 and answer any queries specifically raised by him. When evaluating transaction (a) you should compute the carrying value of the goodwill following the impairment review. When evaluating transaction (b) you do NOT need to prepare detailed calculations.

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

(25 marks)

DipIFR 07 June Questions

4 (a) Kappa is an entity that operates in a sector where the recruitment and retention of high quality employees is particularly important in order to achieve corporate goals. You are the financial controller of Kappa and you have recently received a memorandum from a member of the board of directors. The memorandum includes the following key issues:

(i) The board is eager to reward employees appropriately but is aware that large salary payments have an immediate impact on the liquidity and earnings per share of Kappa.

(ii) A more appropriate method of remuneration is to grant key employees share options that will vest at a future date if the employees comply with specified conditions (such as continued employment) or achieve specific performance targets (such as completing an assignment to a specified standard or achieving a specified growth in the share price). This would allow employees to exercise the options at an appropriate time for them and would prevent an immediate impact on the liquidity or earnings per share of Kappa at the grant date.

Required:

Draft a reply that responds to the observations made by the board. Your reply should focus on the impact on the balance sheet and income statement of Kappa rather than the personal tax positions of the employees. Your reply should contain a summary of the appropriate provisions of IFRS 2 – *Share-based payment*.

(10 marks)

(b) On 1 April 2006 the board of Kappa granted key employees share options that are subject to vesting conditions. Details of the award are as follows:

(i) 50 employees can potentially receive 5,000 options each on 31 March 2008. The options that vest (see below) will allow the employees to purchase shares in Kappa at any time in the year to 31 March 2009 for $15 per share. The par (or nominal) value of the shares is $1 per share.

(ii) The options only vest if the employees remain as employees of Kappa until 31 March 2008 and if the share price of Kappa is at least $20 by that date.

(iii) On 1 April 2006 the board of Kappa estimated that five of the 50 employees would leave in the following two years. Three of the employees left in the year ended 31 March 2007 and at that date the board considered that a further three would leave in the year to 31 March 2008.

(iv) On 1 April 2006 the share price of Kappa was $15. The price had risen to $18 by 31 March 2007 and the directors are reasonably confident that the price will exceed $20 by 31 March 2008.

(v) On 1 April 2006 the directors estimated that the fair value of one of the granted options was $4·50. This estimate had risen to $5 by 31 March 2007.

Required:

Show the impact of the granting of the options on the income statement of Kappa for the year ended 31 March 2007 and on the balance sheet of Kappa as at 31 March 2007. Ignore deferred taxation.

(7 marks)

DipIFR 07 June Questions

(c) Having read your reply and seen the impact of the granting of the options on the financial statements for the year ended 31 March 2007, the directors want to know the likely impact of the transactions in (b) on the financial statements of future years under the following assumptions:

The directors' estimates about the number of relevant employees who leave in the year ended 31 March 2008 proving to be accurate.

The employees exercising their options in 90% of cases in the year ended 31 March 2009 and the unexercised options lapsing on 31 March 2009.

Required:

Show the impact of the above assumptions regarding the options on the income statements of Kappa for the years ended 31 March 2008 and 2009 and on the balance sheet of Kappa as at 31 March 2008 and 2009. Ignore deferred taxation. (8 marks)

(25 marks)

DipIFR 07 June Questions

5 Omega prepares financial statements under International Financial Reporting Standards. In the year ended 31 March 2007 the following transactions occurred:

Transaction 1

On 1 April 2006 Omega began the construction of a new production line. Costs relating to the line are as follows:

Details	**Amount $'000**
Costs of the basic materials (list price $12·5 million less a 20% trade discount)	10,000
Recoverable sales taxes incurred not included in the purchase cost.	1,000
Employment costs of the construction staff for the three months to 30 June 2006 (Note 1)	1,200
Other overheads directly related to the construction (Note 2)	900
Payments to external advisors relating to the construction	500
Expected dismantling and restoration costs (Note 3)	2,000

Note 1

The production line took two months to make ready for use and was brought into use on 31 May 2006.

Note 2

The other overheads were incurred in the two months ended 31 May 2006. They included an abnormal cost of $300,000 caused by a major electrical fault.

Note 3

The production line is expected to have a useful economic life of eight years. At the end of that time Omega is legally required to dismantle the plant in a specified manner and restore its location to an acceptable standard. The figure of $2 million included in the cost estimates is the amount that is expected to be incurred at the end of the useful life of the production plant. The appropriate rate to use in any discounting calculations is 5%. The present value of $1 payable in eight years at a discount rate of 5% is approximately $0·68.

Note 4

Four years after being brought into use, the production line will require a major overhaul to ensure that it generates economic benefits for the second half of its useful life. The estimated cost of the overhaul, at current prices, is $3 million.

Note 5

Omega computes its depreciation charge on a monthly basis.

Note 6

No impairment of the plant had occurred by 31 March 2007.

(13 marks)

Transaction 2

On 31 December 2006 the directors decided to dispose of a property that was surplus to requirements. They instructed selling agents to find a suitable purchaser and advertised the property at a commercially realistic price.

The property was being measured under the revaluation model and had been revalued at $15 million on 31 March 2006. The depreciable element of the property was estimated as $8 million at 31 March 2006 and the useful economic life of the depreciable element was estimated as 25 years from that date.

On 31 December 2006 the directors estimated that the market value of the property was $16 million, and that the costs incurred in selling the property would be $500,000. The property was sold on 30 April 2007 for $16·1 million. Omega incurred selling costs of $550,000. The actual selling price and costs to sell were consistent with estimated amounts as at 31 March 2007.

The financial statements for the year ended 31 March 2007 were authorised for issue on 15 May 2007.

(12 marks)

DipIFR 07 June Questions

Required:

Show the impact of the above transactions on the income statement of Omega for the year ended 31 March 2007, and on its balance sheet as at 31 March 2007. You should state where in the income statement and the balance sheet relevant balances will be shown.

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

(25 marks)

End of Question Paper

Diploma in International Financial Reporting

Thursday 4 December 2008

Dip IFR

Time allowed
Reading and planning: 15 minutes
Writing: 3 hours

This paper is divided into two sections:

Section A – This ONE question is compulsory and MUST be attempted

Section B – THREE questions ONLY to be attempted

Do NOT open this paper until instructed by the supervisor.
During reading and planning time only the question paper may be annotated. You must NOT write in your answer booklet until instructed by the supervisor.
This question paper must not be removed from the examination hall.

The Association of Chartered Certified Accountants

ACCA

Section A – This ONE question is compulsory and MUST be attempted

1 Alpha holds investments in two other entities, Beta and Gamma. The statements of financial position of the three entities at 30 September 2008 were as follows:

	Alpha $'000	Beta $'000	Gamma $'000
Assets			
Non-current assets:			
Property, plant and equipment (Note 1)	144,000	100,000	112,000
Investments (Notes 1 and 2)	113,000	Nil	Nil
	257,000	100,000	112,000
Current assets:			
Inventories (Note 3)	40,000	32,000	28,000
Trade receivables (Note 4)	48,000	30,000	32,000
Other current assets (Note 2)	800	Nil	Nil
Cash and cash equivalents	9,000	8,000	10,000
	97,800	70,000	70,000
Total assets	354,800	170,000	182,000
Equity and Liabilities			
Equity			
Share capital ($1 shares)	100,000	70,000	60,000
Retained earnings	158,800	39,000	56,000
Total equity	258,800	109,000	116,000
Non-current liabilities:			
Long-term borrowings (Note 2)	40,000	28,000	32,000
Deferred tax	20,000	8,000	10,000
Total non-current liabilities	60,000	36,000	42,000
Current liabilities:			
Trade and other payables (Note 4)	30,000	18,000	20,000
Short term borrowings	6,000	7,000	4,000
Total current liabilities	36,000	25,000	24,000
Total equity and liabilities	354,800	170,000	182,000

Note 1 – Investment in Beta:
On 1 April 2007 Alpha purchased 56 million shares in Beta for an immediate cash payment of $90 million. The retained earnings of Beta at 1 April 2007 were $30 million. The terms of the business combination provide for the payment of an additional $12 million on 31 March 2009 if the performance of Beta reaches a specified level in the two year period ended 31 March 2009. The directors of Alpha estimated that the fair value of the contingent consideration at 1 April 2007 was $10 million. This estimate was unchanged at 30 September 2008. The statement of financial position of Alpha includes this investment at its original cost of $90 million.

The directors of Alpha carried out a fair value exercise to measure the identifiable assets and liabilities of Beta at 1 April 2007. The following matters emerged:

Land having a carrying value of $10 million had an estimated market value of $15 million.

Plant and equipment having a carrying value of $40 million had an estimated market value of $44 million. The estimated future economic life of the plant at 1 April 2007 was four 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 directors of Alpha estimated that the fair value of the non-controlling interest in Beta on 1 April 2007 was $21 million. It is Alpha's policy to measure the non-controlling interest at the date of acquisition at its fair value in the consolidated financial statements.

Note 2 – Investment in Gamma:
On 1 October 2006 Alpha paid $15 million for 25% of the equity shares of Gamma, a company that was incorporated on that date. The company was established as part of an agreement with three other investors, who also each subscribed for 25% of the equity shares. The terms of the agreement are such that Gamma is regarded as a joint venture by the investors.

On 1 October 2006 each investor provided Gamma with a long term loan of $8 million, at an annual rate of interest of 10%, payable in arrears. Gamma paid the interest for the year ended 30 September 2008 on 12 October 2008 and included the unpaid interest in its trade payables at 30 September 2008. The other current assets of Alpha represent the interest receivable from Gamma at 30 September 2008.

Gamma has not paid any dividends since incorporation and is unlikely to do so in the foreseeable future.

Note 3 – inter-company sale of inventories
The inventories of Beta and Gamma at 30 September 2008 included components purchased from Alpha during the year at a cost of $20 million to Beta and $16million to Gamma. Alpha supplied these components at cost plus a mark up of one-third.

Note 4 – trade receivables and payables
The trade receivables of Alpha included $5 million receivable from Beta and $4 million receivable from Gamma in respect of the purchase of components (see Note 3). The trade payables of Beta and Gamma include an equivalent amount payable to Alpha.

Note 5 – other information
The goodwill arising on acquisition of Beta has not suffered any impairment since 1 April 2007.

The rate of tax to apply to temporary differences is 25%.

Alpha uses proportional consolidation in its consolidated financial statements whenever permitted by International Financial Reporting Standards.

Required:

Prepare the consolidated statement of financial position of Alpha at 30 September 2008.

(25 marks)

DipIFR 08 Dec Questions

Section B – THREE questions ONLY to be attempted

2 Delta's financial statements for the year ended 30 September 2008 are being prepared and you are provided with the following trial balance at that date:

	$'000	$'000
Revenue (Note 1)		355,000
Inventories at 1 October 2007	45,000	
Raw material purchases	180,000	
Production costs (Note 4)	45,000	
Distribution costs	10,000	
Administrative expenses	30,000	
Property, plant and equipment:		
– at cost (Note 3)	180,000	
– accumulated depreciation at 30 September 2007 (Note 3)		40,000
Lease deposit (Note 3)	10,000	
Construction contract (Note 4)	25,000	
Finance cost of long-term borrowing (Note 5)	15,500	
Income tax account (Note 6)		500
Deferred tax (Note 6)		5,000
Trade receivables	110,000	
Cash and cash equivalents	34,500	
Trade payables		60,000
Long-term borrowings (Note 5)		80,000
Equity share capital ($1 shares)		100,000
Equity dividend paid 30 June 2008	30,000	
Retained earnings at 30 September 2007		74,500
	715,000	715,000

Notes to the trial balance

Note 1 – Revenue

On 29 September 2008 Delta sold goods for a total sales price of $7·2 million. These goods are to be used by the customer on a long-term basis. The contract of sale obliges Delta to provide two years servicing to the customer for no additional payment. The normal selling price of the goods without any agreement to provide servicing would have been $6·4 million. A service contract of the type being provided by Delta to this customer would normally produce service revenue of $800,000 per annum. Delta has included revenue of $7·2 million in the trial balance.

Note 2 – Inventories

On 30 September 2008 the value of the inventories at cost at Delta's premises was $50 million.

Note 3 – Property, plant and equipment

	Cost	Accumulated depreciation at 30 September 2007
	$'000	$'000
Property	90,000	20,000
Plant and equipment	90,000	20,000
	180,000	40,000

(i) Depreciation of all property, plant and equipment should be charged to cost of sales.

(ii) The plant and equipment is being depreciated on a straight-line basis over five years. None of the plant and equipment held at 30 September 2007 was fully depreciated at that date. No disposal of property, plant and equipment occurred in the period.

(iii) The depreciable element of the property has an allocated cost of $40 million and is being depreciated on a straight-line basis over 50 years. On 1 April 2008 the directors of Delta decided to dispose of this property. The property had an estimated market value at 1 April 2008 of $67 million, with costs to sell estimated at $800,000.

DipIFR 08 Dec Questions

The directors immediately offered the property for sale at $67 million. After active marketing of the property a buyer was found and contracts were exchanged on 15 October 2008. A sale was completed on 31 October 2008 at $67 million – actual costs to sell were $800,000.

(iv) On 1 April 2008 Delta commenced to trade from a leasehold property. They correctly classified this lease as an operating lease. The lease term was 20 years from 1 April 2008 and the directors paid a deposit of $10 million to the landlord on 1 April 2008. The lease rentals payable for the period were correctly accounted for and appear as production costs in the trial balance.

Note 4 – Construction contract

On 1 October 2007 Delta began a substantial construction project for a customer. The fixed contract price was $60 million and the estimated duration of the contract was two years. On that date they purchased plant for $15 million and materials for $10 million, both amounts being for exclusive use on the contract. They debited both amounts to the contract account that appears in the trial balance. They also used employees at a monthly cost of $500,000 throughout the 12 month period beginning on 1 October 2007. These employee costs are included in production costs in the trial balance.

On 1 October 2008 Delta purchased additional materials for exclusive use on the contract at a cost of $10 million. They expect to require employees to work on the contract at a monthly cost of $400,000 for the 12 month period to 30 September 2009 but these are the only additional costs they expect to incur in future on this contract.

The plant and equipment purchased for use on the contract is expected to have no residual value on 30 September 2009.

The directors of Delta considered that the contract was 50% complete at 30 September 2008.

Note 5 – Long term loan

On 1 October 2007 Delta issued a loan note at a fixed annual interest rate of 6%. The principal sum of $80 million was repayable on 30 September 2012 and the annual interest of $4·8 million ($80 million x 6%) was payable annually in arrears. The loan note was issued at a discount. The investors paid Delta $70 million and Delta incurred costs of $700,000 in connection with the loan. The effective annual interest rate on this loan note is approximately 9·5%. The costs associated with this loan note for the current period of $15·5 million (the discount on issue of $10 million, the issue costs of $700,000 and the first year's interest paid of $4·8 million) are shown as finance costs in the trial balance.

Note 6 – Income tax

(i) On 30 June 2008 Delta made full and final payment to discharge the income tax liability for the year ended 30 September 2007. The balance on the income tax account in the trial balance is the residue after making that payment.

(ii) The estimated income tax liability for the year ended 30 September 2008 is $19 million.

(iii) A credit of $2·6 million is required to the deferred tax account.

Required:

(a) Prepare the income statement for Delta for the year ended 30 September 2008. (14 marks)

(b) Prepare the statement of financial position for Delta as at 30 September 2008. (11 marks)

Note: notes to the income statement and statement of financial position are not required.

(25 marks)

3 Epsilon is a listed entity. You are the financial controller of the entity and its consolidated financial statements for the year ended 30 September 2008 are being prepared. Your assistant, who has prepared the first draft of the statements, is unsure about the correct treatment of a number of transactions and has asked for your advice. Details of the transactions are given below:

Transaction (a)
On 31 August 2008 the directors decided to close a business segment which did not fit into its future strategy. The closure commenced on 5 October 2008 and was due to be completed on 31 December 2008. On 6 September 2008 letters were sent to relevant employees offering voluntary redundancy or redeployment in other sectors of the business. On 13 September 2008 negotiations commenced with relevant parties with a view to terminating existing contracts of the business segment and arranging sales of its assets. Latest estimates of the financial implications of the closure are as follows:

(i) Redundancy costs will total $30 million, excluding the payment referred to in (ii) below.
(ii) The pension plan (a defined benefit plan) will make a lump sum payment totalling $8 million to the employees who accept voluntary redundancy for termination of their rights under the plan. Epsilon will pay this amount into the plan on 31 January 2009. The actuaries have advised that the accumulated pension rights that this payment will extinguish have a present value of $7 million and this sum is unlikely to alter significantly before 31 January 2009.
(iii) The cost of redeploying and retraining staff who do not accept redundancy will total $6 million.
(iv) The business segment operates out of a leasehold property that has an unexpired lease term of 10 years from 30 September 2008. The annual lease rentals on this property are $1 million, payable on 30 September in arrears. Negotiations with the owner of the freehold indicate that the owner would accept a single payment of $5·5 million in return for early termination of the lease. There are no realistic opportunities for Epsilon to sub-let this property. An appropriate rate to use in any discounting calculations is 10% per annum. The present value of an annuity of $1 receivable annually at the end of years 1 to 10 inclusive using a discount rate of 10% is $6·14.
(v) Plant having a net book value of $11 million at 30 September 2008 will be sold for $2 million.
(vi) The operating losses of the business segment for October, November and December 2008 are estimated at $10 million.

Your assistant is unsure of the extent to which the above transactions create liabilities that should be recognised as a closure provision in the financial statements. He is also unsure as to whether or not the results of the business segment that is being closed need to be shown separately.

Required:

Explain how the decision to close the business segment should be reported in the financial statements of Epsilon for the year ended 30 September 2008. (11 marks)

Transaction (b)
On 1 June 2008 Epsilon opened a new factory in an area designated by the government as an economic development area. On that day the government provided Epsilon with a grant of $30 million to assist it in the development of the factory. This grant was in three parts:

(i) $6 million of the grant was a payment by the government as an inducement to Epsilon to begin developing the factory. No conditions were attached to this part of the grant.
(ii) $15 million of the grant related to the construction of the factory at a cost of $60 million. The land was leased so the whole of the $60 million is depreciable over the estimated 40 year useful life of the factory.
(iii) The remaining $9 million was received subject to keeping at least 200 employees working at the factory for a period of at least five years. If the number drops below 200 at any time in any financial year in this five year period then 20% of the grant is repayable in that year. From 1 June 2008 220 workers were employed at the factory and estimates are that this number is unlikely to fall below 200 over the relevant five year period.

Required:

Explain how the grant of $30 million should be reported in the financial statements of Epsilon for the year ended 30 September 2008. Where International Financial Reporting Standards allow alternative treatments of any part of the grant you should explain both treatments. (9 marks)

DipIFR 08 Dec Questions

Transaction (c)
On 1 September 2008 Epsilon embarked on a major staff training campaign. The training was provided during September 2008. The campaign was outsourced to an external agency. Epsilon paid $4 million to the agency on 1 September 2008 and will be required to pay a further $2 million on 1 December 2009 if its employees achieve specified performance targets related to the training in the year ended 30 September 2009. The directors consider that it will be possible for the employees to achieve these targets. However even with the campaign the targets will be very difficult to achieve.

Required:

Explain:

(i) Whether, in the statement of financial position of Epsilon at 30 September 2008, a provision is necessary for the $2 million that may be payable to the agency.

(ii) Whether any of the expenditure on the staff training campaign can be recognised as an intangible asset in the statement of financial position of Epsilon at 30 September 2008. Your answer should include an explanation of the recognition criteria for intangible assets that are set out in IAS 38 – *Intangible assets*.

(5 marks)

(25 marks)

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4 Extracts from the financial statements of Kappa for the year ended 30 September 2008 are given below:

Statement of comprehensive income of Kappa for the year ended 30 September 2008

	$
Revenue (Note 1)	357,500
Cost of sales (Note 2)	(242,965)
Gross profit	114,535
Distribution costs	(20,000)
Administrative expenses	(25,000)
Finance costs (Note 3)	(12,950)
Profit before tax	56,585
Income tax expense	(14,200)
Profit for the period	42,385
Other comprehensive income for the year	
Gain on property revaluation (Note 2)	22,500
Total comprehensive income for the year	64,885

Statement of changes in equity of Kappa for the year ended 30 September 2008

	Share capital $	Revaluation reserve $	Retained earnings $	Total $
Balance at 1 October 2007	100,000	Nil	45,000	145,000
Comprehensive income for the period		22,500	42,385	64,885
Dividend paid			(20,000)	(20,000)
Issue of share capital	30,000			30,000
Balance at 30 September 2008	130,000	22,500	67,385	219,885

Statement of financial position of Kappa as at 30 September:

	2008 $	2007 $
Assets		
Non-current assets		
Property, plant and equipment (Note 2)	180,000	120,000
Intangible assets (Note 2)	35,000	32,000
	215,000	152,000
Current assets		
Inventories	59,000	52,000
Trade receivables	120,000	100,000
Cash and cash equivalents	68,135	13,500
	247,135	165,500
Total assets	462,135	317,500

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	2008	2007
	$	$
Equity and Liabilities		
Equity		
Share capital	130,000	100,000
Revaluation reserve	22,500	Nil
Retained earnings	67,385	45,000
Total equity	219,885	145,000
Non-current liabilities		
Long-term borrowings (Notes 3 and 4)	101,350	Nil
Deferred tax (Note 5)	14,900	5,000
Deferred income:		
Revenue (Note 1)	15,000	13,000
Government grants (Note 2)	10,000	13,000
Total non-current liabilities	141,250	31,000
Current liabilities		
Trade and other payables (Note 6)	72,000	60,000
Long-term borrowings	Nil	60,000
Deferred income:		
Revenue (Note 1)	14,000	12,500
Government grants (Note 2)	15,000	9,000
Total current liabilities	101,000	141,500
Total equity and liabilities	462,135	317,500

Notes to the extracts from the financial statements

Note 1 – Revenue
Kappa' s revenue is partly receivable in respect of complex transactions where payments are received from a customer in return for the provision of future services. The deferred income relating to revenue represents amounts received or receivable from customers that have not yet been recognised as revenue.

Note 2 – Non-current assets
(i) Cost of sales includes depreciation of property, plant and equipment of $26,000. Plant having a carrying value of $8,000 was disposed of during the period for net proceeds of $6,600. The loss on sale was added to cost of sales and is not included in the $26,000 depreciation figure.
(ii) During the current period $9,000 was included in the income statement relating to government grants as a deduction from cost of sales.
(iii) The property was revalued during the year and a gross surplus of $30,000 arose. This amount, net of related deferred tax, was taken to equity and credited to a revaluation reserve.
(iv) During the period Kappa acquired leased plant at an initial carrying value of $28,000 in property, plant and equipment.
(v) During the current period Kappa charged amortisation of intangible assets of $5,200.

Note 3 – Finance costs
On 1 October 2007 Kappa issued a five year loan. The net amount received from the investors was $89,500. Interest of $6,000 was payable annually in arrears and Kappa made this payment on 30 September 2008. Kappa included finance costs of $8,950 in respect of this loan in the current period's income statement.

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Note 4 – Long-term borrowings

	30 September 2008	30 September 2007
	$	$
Long-term loan (Note 3)	92,450	Nil
Non-current portion of lease liability	8,900	Nil
	101,350	Nil

Note 5 – Deferred tax

	30 September 2008	30 September 2007
	$	$
On property revaluation	7,500	Nil
On other taxable temporary differences	7,400	5,000
	14,900	5,000

Note 6 – Trade and other payables

	30 September 2008	30 September 2007
	$	$
Trade payables	55,000	50,000
Income tax liability	12,000	10,000
Current portion of lease liability	5,000	Nil
	72,000	60,000

Required:

Prepare the statement of cash flows of Kappa for the year ended 30 September 2008 using the presentation format contained in IAS 7 – *Statement of cash flows*. Use the indirect method of computing the operating cash flows.

(25 marks)

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Question 5 begins on page 12.

DipIFR 08 Dec Questions

5 Omega prepares financial statements under International Financial Reporting Standards (IFRS). In the year ended 30 September 2008 the following events occurred:

Event (a)
On 1 August 2008 Omega signed a contract to supply components to Theta on 31 January 2009. Omega does not expect this contract to be onerous. The amount payable by Theta on 31 January 2009 is 30 million Euros. On 1 August 2008 Omega agreed with its bankers to sell 30 million Euros to its bankers for $40 million, with a settlement date of 31 January 2009. No initial payment was made by either Omega or its bankers. A contract could have been made on 30 September 2008 to sell 30 million Euros on 31 January 2009 for $42 million. The directors of Omega have designated the contract with the bank as a hedge of the highly probable future receipt of Euros from Theta. Omega uses hedge accounting where permitted by IFRS. (5 marks)

Event (b)
On 1 October 2007 Omega began to lease a property on a 40-year lease. Omega paid a deposit of $6 million at the start of the lease and was committed to annual rental payments of $800,000. The first payment was made on 30 September 2008 and the final one will be due on 30 September 2047. The fair value of the leasehold interest in the property on 1 October 2007 was $18 million (split 30:70 between the land and buildings elements) and the annual rate of interest implicit in the lease was 6%. The present value of the minimum lease payments (including the deposit) was also approximately $18 million. The estimated useful economic life of the building at 1 October 2007 was 40 years. Omega is fully responsible for all repairs and maintenance of the building throughout the lease term. Omega has no right to purchase the land at the end of the lease. (9 marks)

Event (c)
Omega operates a fleet of 200 delivery vehicles. On 1 January 2008 legislation was passed requiring all such vehicles to undergo modifications to reduce the amount of harmful emissions they produce or face large ongoing financial penalties. The legislation required that modifications be completed by 31 March 2008. The approximate cost of such modifications is $5,000 per vehicle. Omega has not yet modified any of its vehicles. The government has not yet imposed any penalties on Omega but the legislation indicates that the annual penalty will be $4,000 per vehicle. This amount will be payable for every complete year from 1 April 2008 that modifications do not take place and vehicles continue to be operated. The penalty will be levied pro-rata for any part year of non compliance. (4 marks)

Event (d)
On 30 September 2005 Omega purchased 80% of the equity of Kappa for $190 million. The fair values of the net assets of Kappa that were included in the consolidated statement of financial position of Omega at 30 September 2005 were measured at $200 million (their fair values at that date). It is the group policy to value the non-controlling interest in subsidiaries at the date of acquisition at its proportionate share of the fair value of the subsidiaries' identifiable net assets.

On 30 September 2008 Omega carried out its annual review of the goodwill on consolidation of Kappa for evidence of impairment. No impairment had been evident when the reviews were carried out on 30 September 2006 and 30 September 2007. The review involved allocating the assets of Kappa into three cash-generating units and computing the value in use of each unit. The carrying values of the individual units before any impairment adjustments are given below:

	Unit A	Unit B	Unit C
	$m	$m	$m
Intangible assets	30	10	–
Property, plant and equipment	80	50	60
Current assets	60	30	40
	170	90	100
Value in use of unit	180	66	104

It was not possible to meaningfully allocate the goodwill on consolidation to the individual cash generating units but all the other net assets of Kappa are allocated in the table shown above. The intangible assets of Kappa have no ascertainable market value but all the current assets have a market value that is at least equal to their carrying value. The value in use of Kappa as a single cash-generating unit at 30 September 2008 is $350 million. (7 marks)

Required:

Explain how each event should be reported in the financial statements of Omega for the year ended 30 September 2008. In each case you should compute any amounts recognised in the statement of comprehensive income and the statement of financial position. Ignore the taxation effects. You do not need to discuss the disclosures that would be needed.

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

(25 marks)

End of Question Paper

DipIFR 08 Dec Questions

Diploma in International Financial Reporting

Dip IFR

Thursday 5 June 2008

Time allowed
Reading and planning: 15 minutes
Writing: 3 hours

This paper is divided into two sections:

Section A – This ONE question is compulsory and MUST be attempted

Section B – THREE questions ONLY to be attempted

Do NOT open this paper until instructed by the supervisor.
During reading and planning time only the question paper may be annotated. You must NOT write in your answer booklet until instructed by the supervisor.
This question paper must not be removed from the examination hall.

The Association of Chartered Certified Accountants

ACCA

Section A – This ONE question is compulsory and MUST be attempted

1 The income statements and summarised statements of changes in equity of Alpha, Beta and Gamma for the year ended 31 March 2008 are given below:

Income Statements

	Alpha	Beta	Gamma
	$'000	$'000	$'000
Revenue	150,000	100,000	96,000
Cost of sales	(110,000)	(78,000)	(66,000)
Gross profit	40,000	22,000	30,000
Distribution costs	(7,000)	(6,000)	(6,000)
Administrative expenses	(8,000)	(7,000)	(7,200)
Profit from operations	25,000	9,000	16,800
Investment income	5,000	500	500
Finance cost	(4,000)	(3,000)	(3,200)
Profit before tax	26,000	6,500	14,100
Income tax expense	(7,000)	(1,800)	(3,600)
Net profit for the period	19,000	4,700	10,500

Summarised Statements of Changes in Equity

Balance at 1 April 2007	122,000	91,000	82,000
Net profit for the period	19,000	4,700	10,500
Dividends paid on 31 January 2008	(6,500)	(3,000)	(5,000)
Balance at 31 March 2008	134,500	92,700	87,500

Note 1 – purchase of shares in Beta
On 1 October 2005 Alpha purchased an 80% equity shareholding in Beta. The equity of Beta as shown in its own financial statements at that date was $32 million.

Alpha issued 20 million shares to the former shareholders of Beta in exchange for the shares purchased. The market value of Alpha's shares on 1 October 2005 was $2.

At the date of acquisition Beta owned a property with a book value of $28 million and a market value of $35 million. Beta had purchased the property for $30 million on 1 October 2000 and estimated that the depreciable amount of the property (the buildings element) was $16 million at 1 October 2000. The estimated useful economic life of the building at 1 October 2000 was 40 years.

The directors of Alpha estimated that the buildings element of the property comprised 50% of its market value at 1 October 2005. They considered that the original estimate of the total useful economic life of the buildings element (40 years from 1 October **2000**) was still valid.

At 1 October 2005 the plant of Beta had a book value of $12 million and a market value of $15 million. The plant is depreciated on a straight line basis and the remaining useful economic life of the plant at 1 October 2005 was estimated at five years.

All depreciation is charged on a monthly basis and presented in cost of sales. No adjustments were made to the individual financial statements of Beta to reflect the information given in this note.

Note 2 – purchase of shares in Gamma
On 1 July 2007 Alpha purchased 40% of the equity shares of Gamma. This purchase allowed Alpha to exercise a significant influence over Gamma, but Alpha was not able to control its operating and financial policies. No material differences between the market value and the book value of the net assets of Gamma was apparent at the date of the share purchase.

DipIFR 08 June Questions

Note 3 – impairment reviews
An impairment review at 31 March 2008 indicated that 25% of the goodwill on acquisition of Beta needed to be written off. Apart from this, no other impairments of goodwill on acquisition of Beta have been required.

No impairment of the investment in Gamma has yet been necessary.

All impairments are charged to cost of sales.

Note 4 – inter-company sales
Alpha supplies products used by Beta and Gamma. Sales of the products to Beta and Gamma during the year ended 31 March 2008 were as follows (all sales were made at a mark up of 25% on cost):

– Sales to Beta $12·5 million.
– Sales to Gamma (all in the post-acquisition period) $4 million.

At 31 March 2008 and 31 March 2007 the inventories of Beta and Gamma included the following amounts in respect of goods purchased from Alpha.

	Amount in inventory at	
	31 March 2008	31 March 2007
	$'000	$'000
Beta	3,000	1,600
Gamma	2,000	Nil

Note 5 – dividend payments
The dividend received from Gamma on 31 January 2008 was credited to the income statement of Alpha as investment income as the post-acquisition profits of Gamma were in excess of the dividend received.

Required:

(a) Prepare the consolidated income statement for Alpha for the year ended 31 March 2008. (18 marks)

(b) Prepare the summarised consolidated statement of changes in equity for Alpha for the year ended 31 March 2008.

(7 marks)

Note: ignore deferred tax.

(25 marks)

DipIFR 08 June Questions

Section B – THREE questions ONLY to be attempted

2 The trial balance of Delta at 31 March 2008 (its financial reporting date) is as follows:

	$'000	$'000
Revenue (Note 1)		164,000
Production costs (Note 2)	90,000	
Distribution costs	8,000	
Administrative expenses	26,000	
Inventories at 31 March 2007	19,710	
Interest paid on interest bearing borrowings (Note 4)	3,000	
Income tax (Note 5)		100
Dividends paid on equity shares	5,000	
Property, plant and equipment (Note 6):		
At cost at 31 March 2008	77,000	
Accumulated depreciation at 31 March 2007		22,610
Trade receivables	53,000	
Cash and cash equivalents	33,000	
Trade payables		12,000
Long term interest bearing borrowings (Note 4)		50,000
Lease rentals (Note 7)	20,000	
Deferred tax (Note 5)		7,000
Issued equity capital		50,000
Retained earnings at 31 March 2007		29,000
	334,710	334,710

Notes to the Trial Balance

Note 1 – revenue
On 1 April 2007 Delta sold goods for a price of $12·1 million. The terms of the sale allowed the customer extended credit and the price was payable by the customer in cash on 31 March 2009. Delta included $12·1 million in revenue for the current year and $12·1 million in closing trade receivables. A discount rate that is appropriate for the risks in this transaction is 10%.

Note 2 – production costs
During the year ended 31 March 2008 Delta sold goods to the value of $20 million under warranty. The terms of the warranty were that if the goods were defective within 12 months of the date of sale, Delta would repair or replace them. The warranty was not offered by Delta in respect of goods sold in previous periods.

The directors of Delta estimate that, for each product sold, there is an 80% chance no defects will occur in that product. Therefore they have not made a provision for the cost of any future warranty claims on the grounds that, for each item sold, the most likely outcome is that no additional costs will be incurred.

Any warranty costs that were incurred were included in the production costs for the year. Where warranty costs were incurred, on average they amounted to 50% of the revenue received from the initial sale of the product. Warranty costs of $800,000 were incurred before the year end and included within production costs in the trial balance.

Note 3 – inventories at 31 March 2008
The carrying value of inventories at 31 March 2008 was $25 million.

Note 4 – long term interest bearing borrowings
On 1 April 2007 Delta borrowed $50 million for five years at an annual interest rate of 6%. The market interest rate on loans at this time was 8% and so the terms of the contract provide for a repayment on 1 April 2012 of more than $50 million. The repayment makes the effective interest rate applicable to the loan 8%. At 31 March 2007 the market value of a loan with identical cash flows was $53 million. Delta does not consider that the loan is part of a trading portfolio.

DipIFR 08 June Questions

Note 5 – tax

– The estimated income tax on the profits for the year to 31 March 2008 is $1·5 million.
– During the year $1·3 million was paid in full and final settlement of income tax on the profits for the year ended 31 March 2007. The statement of financial position at 31 March 2007 had included $1·4 million in respect of this liability.
– At 31 March 2008 the carrying amounts of the net assets of Delta exceeded their tax base by $28 million. This information is before taking account of the property revaluation (see Note 6 below)
– The rate of income tax in the jurisdiction in which Delta operates is 30%.

Note 6 – property, plant and equipment

Details are as follows:

	Property		Plant and
	Land	Buildings	equipment
	$'000	$'000	$'000
Cost at 31 March 2008 (see below)	22,000	28,000	27,000
Estimate of useful economic life (at date of purchase)	Infinite	50 years	4 years
Accumulated depreciation **at 31 March 2007**	0	5,600	17,010

On 1 April **2007** the open market value of the property was $60 million, including $32 million relating to the building. The directors wish to reflect this revaluation in the financial statements, but no entries regarding the revaluation have yet been made. The directors do not wish to make an annual transfer of excess depreciation to retained earnings. The original estimate of the useful economic life of the building is still considered valid. No assets were fully depreciated at 31 March 2008.

All of the depreciation is to be charged to cost of sales.

Note 7 – Lease rentals

On 1 April 2007 Delta began to lease a large group of machines that were used in the production process. The lease was for 4 years and the annual rental (payable in advance on 1 April each year) was $20 million. The lessor paid $71 million for the machines on 31 March 2007. The lessor has advised Delta that the lease is a finance lease and that the rate of interest implicit in the lease can be taken as 9% per year.

Required:

(a) Prepare the statement of comprehensive income for Delta for the year ended 31 March 2008. (14 marks)

(b) Prepare the statement of financial position for Delta as at 31 March 2008 (11 marks)

Note: notes to the statement of comprehensive income and statement of financial position are not required.

(25 marks)

DipIFR 08 June Questions

3 Epsilon is a listed entity. You are the financial controller of the entity and its consolidated financial statements for the year ended 31 March 2008 are being prepared. Your assistant, who has prepared the first draft of the statements, is unsure about the correct treatment of a number of transactions and has asked for your advice. Details of the transactions are given below:

Transaction (a)

On 1 April 2007 Epsilon began to extract minerals from a large site that it had recently constructed. The direct costs of constructing the site totalled $25 million. The directors of Epsilon estimate that an appropriate allocation of general administrative costs to this project would be $2·5 million. The site has an expected useful economic life of 10 years and at the end of that period the cost of rectifying the damage to the environment caused by the construction of the site is estimated at $6 million. Epsilon is under no legal obligation to rectify this damage, but its published policies indicate that rectification is its usual practice in such circumstances.

Your assistant has included $27·5 million in property, plant and equipment and charged $2·75 million depreciation in the income statement. He has not included any provision for the cost of rectifying the environmental damage because Epsilon has no legal obligation to rectify it and could therefore choose not to.

The relevant discount rate to be used in any calculations is 8% per annum and the present value of $1 receivable at the end of 10 years at this rate is 46·32 cents. (7 marks)

Transaction (b)

Since 1 July 2006 Epsilon has been engaged in a development project with the aim of improving the efficiency of its mineral extraction process. In the year ended 31 March 2007 Epsilon incurred costs of $4 million on this project and charged them to the income statement.

On 31 December 2007 the directors of Epsilon formally evaluated this project and concluded that it was technically feasible and commercially viable. They further concluded that the likely cost savings the project would generate would be $1 million per annum for at least 10 years from 1 October 2008.

In the year ended 31 March 2008 Epsilon incurred costs of $500,000 per month on this project for the first six months and $400,000 per month for the second six months, an annual total of $5·4 million.

In the draft financial statements, the assistant has adjusted opening retained earnings in the statement of changes in equity to reflect the error made in writing off the $4 million costs to the income statement in the year ended 31 March 2007. This amount, plus the costs incurred during the year of $5·4 million, a total of $9·4 million, has been shown as an intangible asset in the draft statement of financial position. (4 marks)

Transaction (c)

On 1 January 2008 Epsilon signed a contract to take delivery of a machine on 30 June 2008 for a fixed price of 20 million Euros. In order to provide a measure of certainty regarding the cash outflow in dollars, the directors entered into a contract on 1 January 2008 to purchase 20 million Euros on 30 June 2008 for $24 million. The treasury department estimated that this contract had a fair value of $1 million (a financial asset) at 31 March 2008.

In the draft financial statements your assistant has included a payable and an asset of $24 million in current liabilities and non-current assets respectively. (6 marks)

Transaction (d)

On 1 April 2007 Epsilon began to lease a property on a 50 year lease. The useful economic life of the **buildings** was estimated to be 50 years from 1 April 2007.

The market values of the leasehold interests in the property at the start of the lease were equally split between land and buildings and the present value of the minimum lease payments was $5 million – equal to the property's fair value. The annual rentals were $500,000, payable in arrears, the first payment being made on 31 March 2008. The annual rate of interest implicit in the lease was 8%. The property was to be vacated at the end of the lease and there was no option available to Epsilon to purchase it at a favourable price.

Your assistant considered that the lease was an operating lease, since the property was to be vacated at its termination. Therefore he charged $500,000 as a rental expense in the income statement. (8 marks)

DipIFR 08 June Questions

Required:

Explain and quantify the appropriate accounting treatment of the four transactions in the financial statements for the year ended 31 March 2008. For each transaction your explanation should include an evaluation of the treatment that is proposed by your assistant.

Note: the mark allocation is shown against each of the four transactions above.

(25 marks)

DipIFR 08 June Questions

4 The draft income statement of Kappa for its year ended 31 March 2008 is given below:

	$'000
Revenue	110,000
Cost of sales	(50,000)
Gross profit	60,000
Other income	4,000
Distribution costs	(5,000)
Administrative expenses	(10,000)
Finance costs	(14,000)
Profit before tax	35,000
Income tax expense	(9,000)
Profit for the year	26,000

The following notes are relevant to the draft income statement:

Note 1
On 31 March 2008 Kappa was in the process of defending a legal case brought against it for damages caused due to the supply by Kappa of faulty products. Kappa's lawyers provided the following estimates of the likely outcome of the case:

– A 70% chance of defending the case successfully.
– A 20% chance of being required to pay $3 million in damages.
– A 10% chance of being required to pay $5 million in damages.

The draft financial statements included a provision for $1·1 million (70% x nil + 20% x $3 million + 10% x $5 million). The charge in the income statement was made to administrative expenses.

The directors of Kappa have estimated that the legal costs of defending the case will total $400,000. $300,000 of this has already been invoiced by the lawyers covering fees up to and including 31 March 2008. Kappa has included $300,000 in trade payables and charged $300,000 to administrative expenses, but has not provided for the expected future costs of $100,000.

In the event of successfully defending the case, the directors of Kappa believe there is a 'good chance' that they will be able to recover their legal costs, but they have not yet reflected this fact in the draft financial statements.

Note 2
On 1 April 2007 Kappa issued a bond to finance an acquisition. The proceeds of the bond were $50 million. The bond did not permit the holders to receive interest, but it was repayable on 31 March 2012 at an amount of $64·4 million. As an alternative to repayment, the bond-holders can elect to receive equity shares in Kappa on 31 March 2012. On 1 April 2007 the required annual rate of return on bonds that did not carry a conversion option was 10% and without the conversion option the bond issue would only have raised $40 million. On 1 April 2007 the directors of Kappa considered it highly probable that the bond-holders would elect to receive shares on 31 March 2012 and so credited $50 million to equity. No charge has therefore been made in the draft income statement in respect of this bond.

Note 3
On 1 January 2008 Kappa began work on the construction of a substantial asset for a customer. The construction period is estimated at two years, ending on 31 December 2009. The directors of Kappa faced a great deal of competition to secure this contract and so agreed a very competitive fixed price of $30 million. On 1 January 2008 they purchased plant and machinery for use on the contract at a price of $10 million. This plant will have no value at 31 December 2009. Other costs incurred on the contract in the three month period to 31 March 2008 totalled $2 million. The directors of Kappa estimate that further costs of $20 million will be necessary to complete the contract. Expenditure of $12 million ($10 million (plant) + $2 million (other)) has been included as work in progress in the statement of financial position, but no other entries have been made. The contract was $12^1/_2$% complete at 31 March 2008. It is the normal policy of Kappa to record revenue on construction contracts based on the percentage of completion applied to total contract revenue.

DipIFR 08 June Questions

Note 4
On 1 April 2007 Kappa sold a property to a third party for $20 million. The carrying value of the property immediately before sale was $16 million. The profit on sale of $4 million was included in other income in the draft income statement. Kappa leased the property back on a five year lease at an annual rental of $2 million, which was included in administrative expenses. The future useful economic life of the property at 1 April 2007 was estimated at 30 years. At the end of the lease (1 April 2012) Kappa has an option to repurchase the property for its market value at 1 April 2012.

Note 5
On 1 April 2007 Kappa borrowed 40 million euros for 20 years at a fixed annual rate of interest of 6%, payable in arrears. Relevant exchange rates ($ to 1 euro) are:

1·2 on 1 April 2007.
1·25 on 31 March 2008.

The draft financial statements have included interest payable of $3 million (2·4 million euros x 1·25) in the income statement and an exchange loss on the loan of $2 million (40 million euros x ($1·25 – $1·20)) in the statement of comprehensive income.

Note 6
During the year ended 31 March 2008 Kappa carried out a major advertising campaign. This campaign was carefully targeted and the directors of Kappa considered that it had been highly successful and would result in significant additional revenue in the current year and for at least four years afterwards. Therefore the total amount spent – $10 million – was not charged to administrative expenses as would normally be the case with advertising expenditure. Instead the advertising costs were capitalised as an intangible asset and amortised over a five year period. A $2 million amortisation charge was included in administrative expenses for the year ended 31 March 2008.

Note 7
Kappa pays income tax at a marginal rate of 25%. Any adjustments made to the income statement can be assumed to affect the income tax charge at this rate.

Required:

Redraft the income statement of Kappa to reflect any adjustments you consider necessary as a result of the information given in notes 1–7. In all cases you should explain why you have, or have not, made adjustments.

(25 marks)

DipIFR 08 June Questions

5 Omega prepares financial statements under International Financial Reporting Standards. In the year ended 31 March 2008 the following transactions occurred:

(a) Transaction 1

On 1 October 2007 Omega purchased 8 million of Target's 12 million equity shares. The acquisition was financed as follows:

A cash payment of $2·00 per share, $1·20 per share being payable on 1 October 2007 and $0·80 being payable on 30 September 2008. Any discounting calculations should be performed using a cost of capital of 8% per annum.

A share exchange of 1 equity share in Omega for every 2 shares acquired in Target. The market value of a Target share was $3·90 on 1 October 2007. The market values of an Omega share were $4 on 1 October 2007 and $4·20 on 31 March 2008.

A further share issue by Omega on 30 September 2008 of 1 share for every 8 shares acquired in Target provided the profits after tax of Target exceeded a given figure. Estimates indicate that this share issue is likely to be made.

Omega incurred acquisition costs of $600,000. $350,000 of these costs were external due diligence costs, $100,000 were Omega's best estimate of management time spent in negotiating the acquisition, and $150,000 were costs incurred in connection with the issue of Omega's shares.

The directors of Omega carried out a fair value exercise on 1 October 2007 and the following matters emerged:

The net assets of Target that were recognised in Target's own financial statements were $30 million based on their carrying values in the individual financial statements of Target.

On 1 October 2007 the carrying value of Target's freehold property was $15 million. The property had been purchased on 1 October 1997 for $17·5 million and the buildings element of the property (allocated cost $10 million) was being depreciated over its estimated useful economic life of 40 years. On 1 October 2007 the market value of the property was $22 million, of which $12 million related to the buildings element. The original estimate of the useful economic life of the buildings is still considered valid.

On 1 October 2007 Target was engaged in contracts with three different customers under which they supplied each customer for a five year period from 1 October 2007. The directors of Omega believe that this creates an intangible asset with a fair value of $7·5 million. In addition the directors of Omega believe that the fair value of the assembled workforce of Target creates an intangible asset with a fair value of $15 million. The average remaining working life of the employees of Target at 1 October 2007 is 15 years. Neither of these intangible assets has been recognised in the individual financial statements of Target.

At 1 October 2007 Target was engaged in a legal dispute with a customer. The directors of Target consider that the case can be successfully defended and have made no provision for legal costs in its financial statements. The directors of Omega estimated that the fair value of the claim at 1 October 2007 was $600,000. Events since 1 October 2007 have reduced this estimate to $500,000 by 31 March 2008 (these events do not affect the fair value of the claim at 1 October 2007).

Due to the acquisition of Target the directors of Omega intend to reorganise the group, starting in June 2009. The estimated cost of this reorganisation is $20 million.

In the year ended 31 March 2008 Target reported a post-tax profit of $6 million (accruing evenly over the period) and paid a dividend of $1·5 million on 31 December 2007 out of post-acquisition profits. The retained earnings of Omega at 31 March 2008 were $18 million. This figure includes the dividend received from Target but does not include any other adjustments to its own earnings that are required as a result of the acquisition of Target. The acquisition costs of $600,000 referred to above have been charged to retained earnings by Omega. Omega has no subsidiaries other than Target and no associates or joint venture entities.

The goodwill on acquisition of Target had not suffered any impairment at 31 March 2008.

DipIFR 08 June Questions

Required:

(i) Compute the goodwill on acquisition of Target as initially measured at 1 October 2007. (10 marks)

(ii) Compute the balance of retained earnings that will be shown in the consolidated statement of financial position of Omega at 31 March 2008. (9 marks)

Note: your figures should be supported by appropriate explanations, both for amounts you include and for amounts you exclude.

(b) Transaction 2

Omega follows the cost model when measuring its property, plant and equipment. One of its properties was carried in the statement of financial position at 31 March 2007 at $6 million. The depreciable amount of this property was estimated at $3·6 million at 31 March 2007 and the estimated future economic life of the property at 31 March 2007 was 18 years. Omega depreciates its properties on a monthly basis

On 1 January 2008 Omega decided to dispose of the property as it was surplus to requirements and began to actively seek a buyer. On 1 January 2008 Omega estimated that the market value of the property was $7·1 million and that the costs of selling the property would be $80,000. These estimates remained appropriate at 31 March 2008.

The property was sold on 1 June 2008 for net proceeds of $7 million.

Required:

Explain, with relevant calculations, how the property would be treated in the financial statements of Omega for the year ended 31 March 2008 and the year ending 31 March 2009. (6 marks)

(25 marks)

End of Question Paper

Diploma in International Financial Reporting

Thursday 10 December 2009

Dip IFR

Time allowed
Reading and planning: 15 minutes
Writing: 3 hours

This paper is divided into two sections:

Section A – This ONE question is compulsory and MUST be attempted

Section B – THREE questions ONLY to be attempted

Do NOT open this paper until instructed by the supervisor.
During reading and planning time only the question paper may be annotated. You must NOT write in your answer booklet until instructed by the supervisor.
This question paper must not be removed from the examination hall.

The Association of Chartered Certified Accountants

ACCA

Section A – This ONE question is compulsory and MUST be attempted

1 The income statements of Alpha, Beta and Gamma for the year ended 30 September 2009 are given below:

	Alpha $'000	Beta $'000	Gamma $'000
Revenue	240,000	150,000	120,000
Cost of sales	(190,000)	(110,000)	(100,000)
Gross profit	50,000	40,000	20,000
Distribution costs	(7,000)	(6,000)	(6,000)
Administrative expenses	(10,000)	(7,000)	(8,000)
Investment income	18,000	Nil	Nil
Finance cost	(8,000)	(4,000)	(7,200)
Profit/(loss) before tax	43,000	23,000	(1,200)
Income tax expense	(12,800)	(7,500)	Nil
Net profit/(loss) for the year	30,200	15,500	(1,200)

Note 1 – purchase of shares in Beta

On 1 October 2005 Alpha incorporated Beta and subscribed for 100% of its equity shares. Alpha also made a loan of $40 million to Beta at a fixed annual interest rate of 5%. The annual interest for the year ended 30 September 2009 was paid by Beta to Alpha before the year end. The loan is due for repayment on 30 September 2015.

Note 2 – purchase of shares in Gamma

On 1 January 2009 Alpha purchased 80% of the equity shares of Gamma. The purchase consideration was as follows:

– Alpha issued 30 million shares to the shareholders of Gamma. The market price of an Alpha share on 1 January 2009 was $2·00.
– Alpha agreed to make an additional payment of $25 million to the shareholders of Gamma on 31 December 2010. This payment was contingent on the post-acquisition profits of Gamma reaching a specified level in the two-year period ending on 31 December 2010. The directors of Alpha assessed that the fair value of this contingent consideration was $14 million on 1 January 2009. They reassessed the fair value of the contingent consideration at $9 million on 30 September 2009. The decline in the fair value of the contingent consideration was caused by the losses of Gamma made in the post-acquisition period.
– Alpha incurred incremental legal and professional fees of $1 million in connection with the acquisition of Gamma and debited these costs to the cost of investment in Gamma. $400,000 of this amount related to the costs of issuing the Alpha shares.

Note 3 – fair value exercise

The individual financial statements of Gamma as at 1 January 2009 showed net assets of $80 million. The directors of Alpha carried out a fair value exercise on Gamma's net assets. The fair values of the net assets of Gamma were the same as their book values with the exception of:

– Plant and equipment that had a book value of $60 million and a fair value of $66 million. The estimated remaining useful economic life of this plant and equipment was three years at 1 January 2009. Depreciation of plant and equipment is charged to cost of sales.
– A loan liability that was carried at its amortised cost of $32 million. The fixed annual rate of interest payable in arrears on this loan was 10%. The loan is repayable on 31 December 2013. The market rate of interest for this type of loan was 8% per annum at 1 January 2009, therefore the fair value of this loan at that date was $34·55 million.

Note 4 – basis of measurement of non-controlling interests

It is the policy of Alpha to measure non-controlling interests based on their fair value at the date of acquisition. The estimated fair value of the non-controlling interest in Gamma at 1 January 2009 was $15 million.

DipIFR 09 Dec Questions

Note 5 – impairment review
On 30 September 2009 the directors of Alpha reviewed the goodwill on acquisition of Gamma for impairment. They measured the recoverable amount of Gamma (as a single cash-generating unit) at $86 million at that date. All impairments are charged to cost of sales.

Note 6 – intra-group sales
Alpha supplies products used by Beta and Gamma. Sales of the products to Beta and Gamma during the year ended 30 September 2009 were as follows (all sales were made at a profit margin of 20%):

– Sales to Beta $20 million.
– Sales to Gamma (all since 1 January 2009) $10 million.

The inventories of Beta and Gamma included the following amounts in respect of goods purchased from Alpha.

	Amount in inventory at	
	30 September 2009	30 September 2008
	$'000	$'000
Beta	4,000	2,400
Gamma	2,500	nil

Note 7 – dividend payments
In the year ended 30 September 2009 Alpha and Beta paid dividends to their equity shareholders of $20 million and $10 million respectively.

Note 8 – losses of Gamma
The individual financial statements of Gamma do not recognise a deferred tax asset in respect of the losses of Gamma. However, in the tax jurisdiction in which the group operates it is possible for the tax losses of one group company to be relieved against the taxable profits of another, but only to the extent that these losses arise after the date of acquisition of the relevant group company. The directors of Alpha estimate that a post-acquisition tax benefit of $300,000 will accrue to the group as a result of this possibility.

Required:

Prepare the consolidated income statement of Alpha for the year ended 30 September 2009.

Note: ignore deferred tax on adjustments for fair value and intra-group profits. Ignore the impact of discounting on the measurement of the contingent consideration.

(25 marks)

DipIFR 09 Dec Questions

Section B – THREE questions ONLY to be attempted

2 The trial balance of Delta at 30 September 2009 (its financial reporting date) was as follows:

	$'000	$'000
Revenue (Note 1)		184,800
Lease rentals paid (Note 1)	7,200	
Suspense account (Note 1)	25,600	
Production costs (Note 2)	115,000	
Distribution costs	9,000	
Administrative expenses	20,000	
Inventories at 30 September 2008	37,500	
Dividends paid (Note 4)	7,900	
Income tax (Note 5)		200
Property, plant and equipment (Note 1 and 6):		
At cost at 1 October 2008	125,000	
Accumulated depreciation at 1 October 2008		32,000
Trade receivables	51,000	
Cash and cash equivalents	13,800	
Trade payables		18,000
Preference shares issued (Note 4)		64,000
Deferred tax (Note 5)		8,000
Issued equity capital		70,000
Retained earnings at 30 September 2008		35,000
	412,000	412,000

Notes to the Trial Balance

Note 1 – revenue

On 1 October 2008 Delta sold some of its plant and equipment to a finance company. Delta credited the sales proceeds of $25·6 million to revenue. The plant and equipment was purchased by Delta on 1 October 2007 at a total cost of $32 million and was being depreciated over its estimated useful life of five years. On 1 October 2008 Delta removed the cost and accumulated depreciation on this asset from the cost and accumulated depreciation accounts. They included these amounts in a suspense account. The recoverable amount of the plant on 1 October 2008 was in excess of its carrying amount.

On 1 October 2008 Delta began to lease the plant and equipment from the finance company on a four-year lease. Lease rentals were $7·2 million, payable annually in advance. Had Delta borrowed funds from the finance company on 1 October 2008, the annual interest rate would have been 8·5%.

Note 2 – production costs

Production costs include the following amounts relating to a construction contract that commenced on 1 October 2008 and is expected to be of two years duration:

	$'000
Purchase of materials for use on the contract	10,000
Purchase of plant for use on the contract. This plant is expected to have no residual value at the end of the contract	24,000
Other direct costs of the contract	8,000
Progress payment received on 30 September 2009	(25,000)
	17,000

Contract estimates indicate that further material purchases totalling $8 million and other direct costs totalling $6 million will be necessary to complete the contract. The estimates also indicate that the contract was 50% complete on 30 September 2009. When the contract was signed the agreed price was $75 million.

Note 3 – inventories at 30 September 2009

The carrying value of inventories at cost at 30 September 2009 was $39·5 million.

DipIFR 09 Dec Questions

Note 4 – issue of preference shares
On 1 October 2008 Delta issued 65 million preference shares at their par value of $1 each. Costs of issue were $1 million so the net proceeds of the issue were $64 million. The preference shareholders will receive an annual dividend on 30 September each year of $3·9 million. The shares will be redeemed at par on 30 September 2013. The effective annual finance cost attaching to these shares is approximately 6·4%. The first annual dividend was paid on 30 September 2009 and is included in dividends paid. The equity shareholders were paid a dividend of $4 million in the year.

Note 5 – tax
– The estimated income tax on the profits for the year to 30 September 2009 is $4·5 million.
– During the year $4·2 million was paid in full and final settlement of income tax on the profits for the year ended 30 September 2008. The balance sheet at 30 September 2008 had included $4·4 million in respect of this liability.
– At 30 September 2009 the carrying amounts of the net assets of Delta exceeded their tax base by $35·8 million.
– The rate of income tax in the jurisdiction in which Delta operates is 25%.

Note 6 – property, plant and equipment
Details are as follows:

	Property		Plant and
	Land	Buildings	equipment
	$'000	$'000	$'000
Cost	32,000	38,000	55,000
Estimate of useful economic life (at date of purchase)	Infinite	50 years	5 years
Accumulated depreciation **at 1 October 2008**	0	9,120	22,880

On 31 March 2009 the directors decided to sell the property because more suitable leasehold property had become available at a very competitive cost. They advertised the property for sale at that date at what was considered to be a realistic asking price of $68 million. They estimated that costs of $3 million would be necessary in order to sell the property. On 1 September 2009 they reduced the asking price to $64·5 million and they sold the property at this price shortly after the year end. Costs to sell totalled $2·5 million.

Required:

(a) Prepare the income statement for Delta for the year ended 30 September 2009. (11 marks)

(b) Prepare the statement of financial position for Delta as at 30 September 2009 (14 marks)

Note: notes to the statements are not required. You do not need to prepare a statement of changes in equity.

(25 marks)

DipIFR 09 Dec Questions

3 You are the financial controller of Epsilon. Your assistant is preparing the first draft of the financial statements for the year ended 30 September 2009. He has a reasonable general accounting knowledge but is not familiar with the detailed requirements of all relevant financial reporting standards. There are four issues on which he requires your advice and he has sent you a memorandum as shown below:

Issue 1

We delivered a quantity of components to a customer on 30 June 2009. The invoiced amount was $500,000. We expected to receive payment on 31 August 2009. We have received no cash as yet and on 31 October 2009 our credit control department were informed that the customer has major cash flow problems as a result of the failure of one of its projects sometime in August 2009. They have agreed to allow the customer until 30 September 2010 to settle the debt, by which time they are confident the cash flow problems will be resolved. I'm a little concerned about the time we're allowing here. I believe we would currently expect annual interest of 6% on any money we lend out and we seem to be allowing this customer an interest free payment period. It may be that none of this is relevant anyway because we didn't find out about this problem until 31 October 2009. I don't know what accounting adjustments to make, if any. (8 marks)

Issue 2

On 1 October 2008 we bought a property, consisting of land and buildings, for $20 million (land element $12 million). I have the following information regarding this property.

– The estimated market value of the property on 30 September 2009 was $22 million (land element $13·5 million) and on 30 September 2010 $24 million (land element $14·5 million).
– The estimated useful economic life of the buildings on 1 October 2008 was 40 years. This estimate remains valid.
– We make an annual transfer to retained earnings of the excess depreciation on revalued assets.

I know we use the revaluation model to measure our properties but I have no experience of computing the figures and I do not know what excess depreciation means. Please show me how to compute the figures in the statement of financial position for the property and the revaluation surplus at 30 September 2009 and 2010. Please also show me how to calculate the depreciation charge that will be included in the income statement for the years ended 30 September 2009 and 2010. (7 marks)

Issue 3

On 1 October 2006 we bought a machine for $5 million. We originally estimated a useful economic life of five years with no residual value. This estimate was used in previous years and the carrying value of the asset in the financial statements last year was $3 million. At the start of the year ended 30 September 2009 we looked at these estimates again and now we think the original estimate was over optimistic. The machine is unlikely to generate economic benefits for us after 30 September 2010 but we could expect a scrap value of $200,000 at today's prices. We haven't charged enough depreciation in 2007 and 2008 but I'm not sure how to reflect this – should I change my brought forward figures? (5 marks)

Issue 4

During the year ended 30 September 2009 we supplied a customer with a product that turned out to be faulty. This led to the customer suffering financial loss and the customer has taken out a legal claim against us for the loss suffered. The claim has not yet been settled but it looks like we will have to make a payment of $800,000 to settle the claim sometime early in January 2010. We have investigated the cause of the fault and it turns out it relates to a defective component supplied to us by one of our suppliers. Our legal department intends to make a counter-claim for $800,000 against this supplier so overall we should get compensation. We think this will take around four months. I assume nothing needs to be provided for here because we are covered but do I need any note disclosures? (5 marks)

Required:

Draft a reply to the questions raised by your assistant. Your reply should include any additional explanations you consider relevant. In all cases you should compute the impact on the reported earnings for the years ended 30 September 2009 and 2010.

Note: the mark allocation is shown against each of the four issues above.

(25 marks)

DipIFR 09 Dec Questions

4 In recent years it has become increasingly common for entities to enter into transactions with third parties that are settled by means of a share based payment. IFRS 2 – *Share-based payment* – was issued in order to provide a basis of accounting for such transactions. Share based payments can be equity settled or cash settled.

Required:

(a) Define cash and equity settled share based payments. (3 marks)

(b) Explain the basis of measurement of the fair value of equity settled share based payments. (3 marks)

(c) Explain the accounting treatment of both equity and cash settled share based payment transactions with employees. (8 marks)

(d) Lambda prepares financial statements to 30 September each year. Lambda has a number of highly skilled employees that it wishes to retain and has put two schemes in place to discourage employees from leaving:

Scheme A

On 1 October 2007 Lambda granted share options to 200 employees. Each employee was entitled to 500 options to purchase equity shares at $10 per share. The options vest on 30 September 2010 if the employees continue to work for Lambda throughout the three-year period. Relevant data is as follows:

Date	Share price ($)	Fair value of option ($)	Expected number of employees for whom 500 options will vest
1 October 2007	10	2·40	190
30 September 2008	11	2·60	185
30 September 2009	12	2·80	188

Scheme B

On 1 October 2006 Lambda granted two share appreciation rights to 250 employees. Each right gave the holder a cash payment of $100 for every 50 cent increase in the share price from the 1 October 2006 value to the date the rights vest. The rights vest on 30 September 2009 for those employees who continue to work for Lambda throughout the three-year period. Payment is due on 31 January 2010. Relevant data is as follows:

Date	Share price ($)	Fair value of right ($)	Expected number of employees for whom two rights will vest
1 October 2006	9	500	240
30 September 2007	10	520	235
30 September 2008	11	540	240
30 September 2009	12	600	238 (the actual number in whom 2 rights vested)

Required:

Explain:

(i) For both schemes, compute the charge to the income statement for the year ended 30 September 2009. (8 marks)

(ii) For both schemes, compute the amount that will appear in the statement of financial position of Lambda at 30 September 2009 and state where in the statement the relevant amount will appear. (3 marks)

(25 marks)

DipIFR 09 Dec Questions

5 Omega prepares financial statements to 30 September each year. The financial statements for the year ended 30 September 2009 have not yet been authorised for issue.

(a) On 1 July 2009 the directors decided to terminate production at one of the company's divisions. This decision was publicly announced on 31 July 2009. The activities of the division were gradually reduced from 1 October 2009 and closure is expected to be complete by 31 March 2010. At 31 July 2009 the directors prepared the following estimates of the financial implications of the closure:

(i) Redundancy costs were initially estimated at $2 million. Further expenditure of $800,000 will be necessary to retrain employees who will be affected by the closure but remained with Omega in different divisions. This retraining will begin in early January 2010. Latest estimates are that redundancy costs will be $1·9 million, with retraining costs of $850,000.

(ii) Plant and equipment having an expected carrying value at 30 September 2009 of $8 million will have a recoverable amount $1·5 million. These estimates remain valid.

(iii) The division is under contract to supply a customer for the next three years at a pre-determined price. It will be necessary to pay compensation of $600,000 to this customer. The compensation actually paid, on 30 November 2009, was $550,000.

(iv) The division will make operating losses of $300,000 per month in the last three months of 2009 and $200,000 per month in the first three months of 2010. This estimate proved accurate for October and November 2009.

(v) The division operates out of leasehold premises. The lease is a non-cancellable operating lease with an unexpired term of five years from 30 September 2009. The annual lease rentals (payable on 30 September in arrears) are $1·5 million. The landlord is not prepared to discuss an early termination payment. Following the closure of the division it is estimated that Omega would be able to sub-let the property from 1 April 2010. Omega could expect to receive a rental of $300,000 for the six-month period from 1 April 2010 to 30 September 2010 and then annual rentals of $500,000 for each period ending 30 September 2011 to 30 September 2014 inclusive. All rentals will be received in arrears. Any discounting calculations should be performed using a discount rate of 5% per annum. You are given the following data for discounting at 5% per annum:

Present value of $1 received at the end of year 1 = $0·95
Present value of $1 received at the end of years 1–2 inclusive = $1·86
Present value of $1 received at the end of years 1–3 inclusive = $2·72
Present value of $1 received at the end of years 1–4 inclusive = $3·54
Present value of $1 received at the end of years 1–5 inclusive = $4·32

Required:

Compute the amounts that will be included in the income statement for the year ended 30 September 2009 in respect of the decision to close the division. Your figures should be supported by appropriate explanations. Where financial information provided above does NOT result in a charge to the income statement you should explain why this is so. (13 marks)

(b) The rate of tax that applies to all companies in the Omega group is 25%.The deferred tax liability of Omega at 30 September 2008 was $2 million. This liability related to taxable temporary differences for property, plant and equipment of $8 million. The following information is relevant regarding the computation of deferred tax for the year ended 30 September 2009:

(i) At 30 September 2009 the carrying value of property, plant and equipment was $44 million and its tax base was $27 million. The carrying value of $44 million incorporates a surplus of $6 million that arose as a result of a property revaluation on 30 September 2009. This property revaluation had no effect on the tax base of the property. This property had not previously been revalued.

(ii) Since June 2008 Omega has been carrying out a project to develop a more efficient production process. On 1 April 2009 the project was assessed and found to be at a stage that justified capitalising future costs incurred on the project. Accordingly an intangible asset of $900,000 was included in the draft statement of financial position at 30 September 2009. Amortisation is expected to begin sometime in the year ended 30 September 2010. All expenditure on the project qualifies for tax relief as the expenditure is incurred.

(iii) On 1 September 2009 Omega sold goods to one of its subsidiaries for $4,000,000. The goods cost Omega $3,000,000 to manufacture. Prior to 30 September 2009 the subsidiary sold 40% of the goods to a non-group company for $2,200,000.

(iv) On 30 September 2009 Omega borrowed $20 million from a non-group company. The financial liability is not designated as fair value through profit and loss. Omega incurred costs of $1 million in connection with the borrowing and this qualified for tax relief in the year ended 30 September 2009.

(v) There were no other temporary differences affecting the Omega group at 30 September 2009.

Required:

Compute the charge or credit for deferred tax that will appear in the consolidated income statement of Omega for the year ended 30 September 2009. You should support your figures with relevant explanations.

(12 marks)

(25 marks)

End of Question Paper

DipIFR 09 Dec Questions

Answers

Diploma in Financial Reporting **December 2009 Answers**

1 Consolidated income statement of Alpha for the year ended 30 September 2009

	$'000	*Marks*
Revenue (W1)	450,000	$1^1/_2$ (W1)
Cost of sales (balancing figure)	(348,547)	$^1/_2$
Gross profit (W2)	101,453	$12^1/_2$ (W2)
Distribution costs (7,000 + 6,000 + 9/12 X 6,000)	(17,500)	$^1/_2$
Administrative expenses (10,000 + 7,000 + 9/12 X 8,000 + 600 (Note 2))	(23,600)	$1^1/_2$
Investment income (W6)	6,000	2 (W6)
Finance cost (W7)	(15,073)	$1^1/_2$ (W7)
Other income (decrease in fair value of contingent consideration)	5,000	1
Profit before tax	56,280	
Income tax expense (12,800 + 7,500 – 300 (Note 8))	(20,000)	$^1/_2$ + 1
Net profit for the period	36,280	
Net profit attributable to		
Non-controlling interest (W8)	(600)	2 (W8)
Controlling interest	36,880	$^1/_2$
Net profit for the year	36,280	25

WORKINGS – DO NOT DOUBLE COUNT MARKS

Working 1 – revenue

	$'000	
Alpha + Beta + 9/12 X Gamma	480,000	1
Intra-group sales	(30,000)	$^1/_2$
	450,000	$1^1/_2$

Working 2 – gross profit

	$'000	
Alpha + Beta + 9/12 X Gamma	105,000	1
Unrealised profit adjustments:		
Alpha: (20% (4,000 – 2,400))	(320)	1
Gamma: (20% X 2,500)	(500)	$^1/_2$
Extra depreciation (W3)	(1,500)	$1^1/_2$ (W3)
Impairment of goodwill (W5)	(1,227)	$8^1/_2$ (W5)
	101,453	$12^1/_2$

Working 3 – extra depreciation of plant and equipment

	$'000	
(66,000 – 60,000) X 1/3 X 9/12	1,500	$1^1/_2 \Rightarrow$ (W2)

Working 4 – goodwill on acquisition of Gamma

	$'000	$'000	
Cost of investment:			
Share exchange (30,000 X $2·00)		60,000	1
Contingent consideration		14,000	1
Fair value of non-controlling interest at date of acquisition		15,000	$^1/_2$
		89,000	
Net assets of Gamma at date of acquisition:			
Per own records	80,000		$^1/_2$
Fair value adjustments:			
Plant and equipment (66,000 – 60,000)	6,000		$^1/_2$
Loan (34,550 – 32,000)	(2,550)		$^1/_2$
For consolidation purposes		(83,450)	
So goodwill		5,550	$^1/_2$
			$4^1/_2 \Rightarrow$ (W5)

Working 5 – impairment of goodwill of Gamma

	$'000	$'000	*Marks*
Carrying value of Gamma:			
Fair value at date of acquisition (W4)		83,450	1/2
Post-acquisition loss:			
Per own records (1,200 X 9/12)	(900)		1/2
Extra depreciation (W3)	(1,500)		1/2
Reduced finance cost ((3,200 – (34,550 X 8%)) X 9/12)	327		1
Additional benefit of tax loss	300		1
		(1,773)	
Goodwill (W4)		5,550	4 1/2 (W4)
		87,227	
Recoverable amount		(86,000)	1/2
So impairment equals		1,227	1/2
			8 1/2

Working 6 – investment income

	$'000	
Per accounts of Alpha	18,000	1/2
Dividend received from Beta	(10,000)	1/2
Interest received from Beta (40,000 X 5%)	(2,000)	1
Residue in consolidated income statement	6,000	2

Working 7 – finance cost

	$'000	
Alpha + Beta + 9/12 X Gamma	17,400	1/2
Interest paid by Beta to Alpha (W6)	(2,000)	1/2
Fair value adjustment (W5)	(327)	1/2
Residue in consolidated income statement	15,073	1 1/2

Working 8 – non-controlling interest in Gamma

	$'000	
Net adjusted post-acquisition loss of Gamma (W5)	(2,073)	1/2
Benefit of transfer of tax loss	300	1
Impairment of goodwill	(1,227)	1
	(3,000)	
Non-controlling interest (20%)	(600)	1/2
		3

Note: There are other acceptable methods of allocating the impairment of goodwill between the group and the NCI. Marks will be awarded for sensible alternatives where assumptions are stated.

2 (a) – Delta income statement for the year ended 30 September 2009

	$'000	
Revenue (W1)	196,700	1 1/2 (W1)
Cost of sales (W2)	(141,780)	6 (W2)
Gross profit	54,920	
Distribution costs	(9,000)	1/2
Administrative expenses	(20,000)	1/2
Finance cost (W5)	(5,660)	1 (W5)
Profit before tax	20,260	
Income tax expense (W6)	(5,250)	1 1/2 (W6)
Net profit for the year	15,010	11

			Marks
(b) – Delta statement of financial position as at 31 March 2009			
	$'000	$'000	
ASSETS			
Non-current assets:			
Property, plant and equipment (W7)		52,320	3 (W7)
Current assets:			
Non-current assets held for sale (W8)	60,500		1½ (W8)
Amounts due from customers under construction contract (W9)	14,500		2½ (W9)
Inventories	39,500		½
Trade receivables	51,000		½
Cash and cash equivalents	13,800		½
		179,300	
		231,620	
EQUITY AND LIABILITIES			
	$'000	$'000	
Capital and Reserves:			
Issued capital	70,000		½
Retained earnings (W10)	46,010		1 (W10)
		116,010	
Non-current liabilities:			
Finance lease payable (W11)	12,764		1 (W11)
Preference shares (W12)	64,196		1 (W12)
Deferred tax (25% X 35,800)	8,950		½
		85,910	
Current liabilities:			
Trade and other payables (W13)	29,700		1½ (W13)
		29,700	
		231,620	14

WORKINGS – ALL FIGURES IN $'000 – DO NOT DOUBLE COUNT

1. Revenue

As per TB	184,800	½
Deduct revenue proceeds of sale and leaseback classified as a finance lease	(25,600)	½
Add contract revenue (50% X $75 million)	37,500	½
Per Income Statement	196,700	1½

2. Cost of sales

Opening inventories	37,500	½
Production costs excluding contract costs (115,000 – 17,000)	98,000	½
Closing inventories	(39,500)	½
Contract costs (W3)	28,000	3 (W3)
Depreciation (W4)	17,780	1½ (W4)
Per Income Statement	141,780	6

3. Contract cost of sales

Total costs		
Materials (10,000 + 8,000)	18,000	½
Plant	24,000	½
Other (8,000 + 6,000)	14,000	½
	56,000	
Fixed contract price	75,000	½
So expected profit equals	19,000	
50% earned to date	9,500	½
Revenue recognised to date (W1)	37,500	
So cost of sales equals	28,000	½
		3 ⇒ W2

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			Marks
4.	**Depreciation of non-current assets included in cost of sales**		
	Buildings – 6 months until classified as held for sale – 38,000 X 1/50 X 6/12	380	1/2
	Plant and equipment – as per TB – 1/5 X 55,000	11,000	1/2
	Leased plant – 1/5 X 32,000	6,400	1/2
	Total depreciation for the period	17,780	1 1/2 ⇒ W2
5.	**Finance costs**		
	On finance lease (8·5% X ($25·6 million – $7·2 million))	1,564	1/2
	On preference shares (6·4% X $64 million)	4,096	1/2
		5,660	1
6.	**Income tax expense**		
	Estimate on the profits of the current year	4,500	1/2
	Over-provision in the previous year	(200)	1/2
	Deferred tax ((25% X 35,800) – 8,000)	950	1/2
		5,250	1 1/2
7.	**Property, plant and equipment**		
	Plant and equipment at cost (55,000 + 32,000)	87,000	1/2
	Cost of plant purchased for construction contract	24,000	1/2
	Opening accumulated depreciation – per TB	(22,880)	1/2
	Opening depreciation on finance lease (32,000 X 1/5)	(6,400)	1/2
	Charge for the period in cost of sales (11,000 + 6,400 – W4)	(17,400)	1/2
	Depreciation of plant purchased for construction contract (24,000 X 1/2)	(12,000)	1/2
		52,320	3

Tutorial Note: The treatment of the asset sold and leased back under a finance lease has been to treat the transaction as a secured loan, with no de-recognition of the asset. An alternative treatment, which would result in the same ultimate answer, would be to remove the asset from PPE and then immediately reinstate it at a new 'cost' of $25·6 million, with a remaining useful life of four years. Either treatment, correctly applied, would be acceptable.

8.	**Non-current assets held for sale**		
	Carrying value at start of the year (32,000 + 38,000 – 9,120)	60,880	1/2
	Depreciation to date of classification (W4)	(380)	1/2
	Include at this amount as less than fair value less costs to sell	60,500	1/2
			1 1/2
9.	**Amounts due from customers under construction contract**		
	Costs to date:		
	Materials	10,000	1/2
	Depreciation (W7)	12,000	1/2
	Other	8,000	1/2
	Attributable profit (W3)	9,500	1/2
	Progress payment received	(25,000)	1/2
		14,500	2 1/2
10.	**Retained earnings**		
	Opening balance	35,000	1/2
	Net profit for the period	15,010	
	Equity dividends	(4,000)	1/2
		46,010	1

11\. **Non-current portion of finance lease**
The closing liability is 25,600 – 7,200 + 1,564 = 19,964 — 1/2
Since the payments are in advance 7,200 of this is current and the balance of 12,764 non-current. The current liability could be split into accrued finance costs (1,564) and an accrued capital balance of 5,636. — 1/2

Total: 1

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			Marks
12.	**Preference shares**		
	Initial liability	64,000	$^1/_2$
	Finance cost (W5)	4,096	
	Dividend paid	(3,900)	$^1/_2$
		64,196	1
13.	**Trade and other payables**		
	Trade payables per TB	18,000	$^1/_2$
	Income tax estimate	4,500	$^1/_2$
	Finance lease payable (W11)	7,200	$^1/_2$
	As per closing balance sheet	29,700	$1^1/_2$

3 Issue 1

We do need to take account of the information regarding the financial difficulties of the customer because these arose prior to 30 September 2009. IAS 10 – *Events after the reporting date* – would classify such an event as adjusting since it provides additional evidence of conditions existing at the reporting date. In this case the additional information relates to evidence of impairment of a financial asset. IAS 39 – *Financial instruments: recognition and measurement* – requires that financial assets be reviewed at each reporting date for evidence of impairment. Such evidence exists here because although the customer is expected to pay the amount due the payment date has been deferred. In such circumstances IAS 39 requires that the asset be re-measured at the present value of the expected future receipt, discounted (in the case of a trade receivable) at a current commercial rate of interest. Therefore in the financial statements for the year ended 30 September 2009 asset should be measured at $471,698 ($500,000/1·06) and an impairment loss of $28,302 ($500,000 – $471,698) recognised in the income statement. In the year ended 30 September 2010 interest income of $28,302 ($471,698 X 6%) should be recognised in the income statement.

Issue 2

Properties are treated as 'component assets' for depreciation purposes. The two components are a land component and a buildings component. The buildings component is depreciated and the land component is not. In this case the buildings component is $8 million ($20 million – $12 million) on 1 October 2008 so the depreciation charge for the year ended 30 September 2009 is $200,000 ($8 million X 1/40).

Since the property is carried under the revaluation model its carrying value at 30 September 2009 will be $22 million. The difference between its market value of $22 million and its carrying value immediately before the revaluation of $19·8 million ($20 million – $200,000) will be credited to a revaluation surplus and shown as a component of equity. The balance on this reserve at 30 September 2009 will be $2·2 million ($22 million – $19·8 million).

Following revaluation the depreciable component of the asset is $8·5 million ($22 million – $13·5 million). Since the remaining estimated useful life of the buildings at 1 October 2009 is 39 years the annual depreciation for the year ended 30 September 2010 will be $217,949 ($8·5 million/39).

The excess depreciation is $17,949, which is the difference between the depreciation actually charged on a revalued asset ($217,949) and the depreciation that would have been charged if the asset had never been revalued ($200,000). IAS 16 – *Property, plant and equipment* – allows entities to transfer this amount from the revaluation surplus to retained earnings on an annual basis. This transfer does not affect the income statement.

Following the revaluation at 30 September 2010 the property will have a carrying value of $24 million. Its carrying value immediately prior to the revaluation will be $21,782, 051 ($22 million – $217,949). Therefore a further transfer to the revaluation reserve of $2,217,949 ($24 million – $21,782,051) will be made. The closing balance on the revaluation surplus at 30 September 2010 will be $4·4 million ($2·2 million – $17,949 (the excess depreciation) + $2,217,949).

Issue 3

The calculation of depreciation of a non-current asset involves the making of a number of accounting estimates. In this case two of the estimates, the useful economic life of the asset and the expected residual value, have changed. IAS 8 – *Accounting policies, changes in accounting estimates and errors* – states that when accounting estimates change the change should be made prospectively. Brought forward values are not adjusted.

In this case the future depreciation required on the non-current asset from 1 October 2008 is $2,800,000 ($3,000,000 – $200,000). This should be charged to the income statement over the remaining expected future useful life of the asset from 1 October 2008, in this case two years. Therefore depreciation of $1,400,000 will be charged in 2009 and 2010, unless the accounting estimates change again next year.

Issue 4

It is necessary to consider the two parts of this issue separately. The claim made by our customer needs to be recognised as a liability in the financial statements for the year ended 30 September 2009. IAS 37 – *Provisions, contingent liabilities and contingent assets* – states that a provision should be made when, at the reporting date:

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- An entity has a present obligation arising out of a past event.
- There is a probable outflow of economic benefits.
- A reliable estimate can be made of the outflow.

All three of those conditions are satisfied here and so a provision of $800,000, with a corresponding charge to the income statement is appropriate.

The counter-claim against our supplier is a contingent asset. IAS 37 states that contingent assets should not be recognised until their realisation is virtually certain, but should be disclosed where their realisation is probable. This appears to be the situation we are in here. Therefore the contingent asset would be disclosed by way of note in the 2009 financial statements and, assuming that realisation occurs as expected, recognised as income in the 2010 financial statements.

4 **(a)** A share based payment arises out of a transaction where a third party:

- Receives equity instruments of the entity (including share options) in exchange for goods or services – equity settled share based payment; or
- Receives cash or other assets of the entity of a value that is based on the value of the equity shares of the entity – cash settled share based payment.

(b) In all cases other than transactions with employees, the fair value of equity settled share based payments should be measured with reference to the value of the goods or services provided by the third party. For transactions with employees fair value should be measured with reference to the value of the equity instruments granted.

(c) For equity settled share based payments the amounts recognised should be based on the fair value (see part (b)) of the payments at the grant date, with no adjustments to subsequent changes to fair value. The total cost should be built up over the vesting period (the period between the grant date and the date the third party is unconditionally entitled to the relevant equity instruments). The annual charge to the income statement is the difference between the cumulative amount recognised at the beginning and end of the period. The cumulative balance at the end of the period will be shown within equity. Where the vesting is subject to conditions the cumulative cost should be based on the number expected to vest based on information available at the date the financial statements are authorised for issue. After the vesting date there will be no further increase or decrease within equity. However there may be a transfer from one component of equity to another relating to the exercising or lapsing of equity options.

For cash settled share based payments the liability should be recognised over the vesting period based on its fair value at the date the financial statements are authorised for issue. After the vesting date the liability will continue to be re-measured at fair value until settled.

(d) **(i)** **Scheme A**
The total expected cost of the scheme at 30 September 2009 was $225,600 (500 X 188 X $2·40). So the cumulative charge to the income statement up to that date was $150,400 ($225,600 X 2/3).

The total expected cost of the scheme at 30 September 2008 was $222,000 (500 X 185 X $2·40). So the cumulative charge to the income statement up to that date was $74,000 ($222,000 X 1/3).

Therefore the charge to the income statement for the year is $76,400 ($150,400 – $74,000)

Scheme B
The final cost of the scheme at vesting date (30 September 2009) was $285,600 (2 X 238 X $600).

The total expected cost of the scheme at 30 September 2008 was $259,200 (2 X 240 X $540). So the cumulative charge to the income statement up to that date was $172,800 ($259,200 X 2/3).

Therefore the charge to the income statement for the year is $112,800 ($285,600 – $172,800).

(ii) **Scheme A**
The amount recognised in the statement of financial position is the cumulative amount recognised in the income statement to date – $150,400 (see part (d)(i) above). This amount will be recognised in equity.

Scheme B
Again the cumulative amount is recognised – in this case $285,600 (see part (d)(i) above). This amount will be recognised as a current liability.

5 **(a)** The closure of the division is a restructuring as defined in IAS 37 – *Provisions, contingent liabilities and contingent assets*. IAS 37 states that a constructive obligation to proceed with the restructuring arises when at the reporting date the entity has:

- Commenced activities connected with the restructuring; or
- Made a public announcement of the main features of the restructuring to those affected by it.

In this case a public announcement has been made and so a provision will be necessary at 30 September 2009. This will result in the following charges to the income statement:

(i) Redundancy costs of $1,900,000 (information note (i)). The amount provided is the best estimate of the expenditure at the date the financial statements are authorised for issue. Changes in estimates after the reporting date are taken account of for this purpose as an adjusting event after the reporting date. No charge is necessary for the retraining costs as these are not incurred in 2008/09 and cannot form part of a restructuring provision as they are related to the ongoing activities of the entity.

(ii) Impairment of plant and equipment of $6·5 million (information note (ii)). Although not strictly part of the restructuring provision the decision to restructure before the year end means that related assets need to be reviewed for impairment. In this case the recoverable amount of the plant and equipment is only $1·5 million and under the provisions of IAS 36 – *Impairment of assets* – should be written down to this amount, resulting in a charge of $6·5 million to the income statement.

(iii) Compensation for breach of contract of $550,000 (information note (iii)). The same principle applies here as applied to the redundancy costs (see (i) above).

(iv) No charge is necessary in respect of future operating losses (information note (iv)). Future operating losses relate to future events and provisions are made only for the consequences of past events.

(v) A charge relating to the onerous contract of $4,520,000 (information note (v)). IAS 37 states that an onerous contract is one for which the expected cost of fulfilling the contract exceeds the benefits expected from the contract. Provision is made for the lower of the expected net cost of fulfilling the contract and the cost of early termination (not available in this case). The net cost of fulfilling the contract is $4,510,000 ($1,500,000 X 4·32 – $300,000 X 0·95 – $500,000 X (4·32 – 0·95)).

(b) The charge or credit for deferred tax in the income statement is essentially the movement in the liability from one period to the next, excluding movements that are recognised in other comprehensive income. Therefore the charge is as follows:

(i) Property, plant and equipment. The carrying value is $44 million and the tax base is $27 million. This creates a taxable temporary difference of $17 million and an associated deferred tax liability of $4·25 million ($17 million X 25%). The movement in this liability over the period is $2·25 million ($4·25 million – $2 million). $1·5 million ($6 million X 25%) of this movement relates to the property revaluation and this is recognised in other comprehensive income. $750,000 ($2·25 million – $1·5 million) is recognised in the income statement.

(ii) Intangible asset. The carrying value of the intangible is $900,000 and its tax base is nil because tax relief has already been given. Therefore there is a taxable temporary difference of $900,000 on which deferred tax of $225,000 ($900,000 X 25%) would be recognised. This would create a charge to the income statement of $225,000.

(iii) Intra-group sale. The intra-group sale will result in an adjustment for unrealised profit of $600,000 (60% ($4,000,000 – $3,000,000). Inventory that cost the subsidiary $2,400,000 (60% X $4,000,000) will be included in consolidated inventory at $1,800,000 (60% X $3,000,000). However, when the inventory is sold the group will obtain a tax deduction of $2,400,000. Therefore, at group level, the carrying value of the inventory is $1,800,000 and its tax base is $2,400,000. This creates a deductible temporary difference of $600,000 and a deferred tax asset of $150,000 ($600,000 X 25%) will arise. The existence of larger, offsettable, taxable temporary differences means that there is no problem with recognising this asset. This will lead to a credit of $150,000 in the income statement.

(iv) $20 million loan. The issue costs of the loan will be offset against its carrying value in the financial statements. The issue costs effectively create a taxable temporary difference because the future write off of these issue costs (as part of the future finance cost of the loan) will not attract any tax relief because the tax relief has already been given. Therefore the taxable temporary difference is $1,000,000 and the related deferred tax liability $250,000 ($1,000,000 X 25%). This will create a charge for deferred tax in the income statement.

The overall charge will be $1,075,000 ($750,000 + $225,000 – $150,000 + $250,000).

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Diploma in Financial Reporting Paper DipIFR **December 2009 Marking Scheme**

			Marks
1	Marks as annotated on model answer		25
2	Marks as annotated on model answer		25
3	**(Issue 1)**	Appropriate comments on date information used – up to	2
		Explain asset impaired – with reason – up to	2
		Measure 30 September asset using 6% discount rate – up to	2
		Compute impact on earnings for 2009 and 2010 (1 each)	2
		Total	8
	(Issue 2)	Compute and explain depreciation for year ended 30 September 2009	1
		Compute and explain carrying value at 30 September 2009	1
		Compute revaluation reserve balance at 30 September 2009	1
		Compute depreciation charge for year ended 30 September 2010	1
		Compute carrying value at 30 September 2010	$^1/_2$
		Compute excess depreciation for 2010	1
		Compute revaluation reserve balance at 30 September 2010	$1^1/_2$
		Total	7
	(Issue 3)	Depreciation is an accounting estimate	1
		General description of how to treat	1
		Compute amounts for 2009 and 2010 – up to	3
		Total	5
	(Issue 4)	General principle dealt with in two parts	1
		Deal with provision – up to	2
		Deal with contingent asset – up to	2
		Total	5

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				Marks
4	(a)		Award up to 3 marks	3
	(b)		Award up to 3 marks	3
	(c)		Base equity settled on fair value at grant date	1
			Principle spread cost over vesting period – with explanation	1
			Explain re-measure based on changes in vesting expectations	1
			Explain 'cumulative nature' of measurement	1
			Principles cash settled measurement to fair value updated	1
			Equivalent comments re: vesting conditions and spreading cost – up to	2
			Treatment at maturity for cash settled – fair valued until settled	1
			Total	8
	(d)	(i)	Compute charge to date for scheme A – up to	2
			Compute equivalent amount brought forward for scheme A	1
			So charge for the year is the difference	1
			Compute total charge for scheme B – up to	2
			Compute equivalent amount brought forward for scheme B	1
			So charge for the year is the difference	1
			Total	8
		(ii)	Appreciate cumulative amount in SFP	1
			Scheme A amount in equity	1
			Scheme B amount in liabilities	1
			Total	3
5	(a)		General principle make restructuring provision – with reason	2
			Include redundancy but not retraining – with reason	2
			Include impairment – with reason	2
			Include compensation on contract	1
			Don't include operating losses	1
			Principle (v) is onerous contract	1
			Principle provide for net cost of fulfilling	1
			Numbers for onerous contract – up to	3
			Total	13
	(b)		Basic principle charge is movement in liability	1
			Computation of $750,000 re: PPE – up to	3
			Computation of $225,000 for intangible – up to	2
			Computation of $150,000 credit for inventory – up to	3
			Computation of $250,000 for loan – up to	2
			Aggregate together to produce overall charge	1
			Total	12

DipIFR 09 Dec Questions

Diploma in International Financial Reporting

Thursday 4 June 2009

Dip IFR

Time allowed
Reading and planning: 15 minutes
Writing: 3 hours

This paper is divided into two sections:

Section A – This ONE question is compulsory and MUST be attempted

Section B – THREE questions ONLY to be attempted

Do NOT open this paper until instructed by the supervisor.
During reading and planning time only the question paper may be annotated. You must NOT write in your answer booklet until instructed by the supervisor.
This question paper must not be removed from the examination hall.

The Association of Chartered Certified Accountants

ACCA

Section A – This ONE question is compulsory and MUST be attempted

1 The statements of comprehensive income and summarised statements of changes in equity of Alpha, Beta and Gamma for the year ended 31 March 2009 are given below:

Statements of Comprehensive Income

	Alpha	Beta	Gamma
	$'000	$'000	$'000
Revenue	340,000	180,000	126,000
Cost of sales	(210,000)	(108,000)	(76,000)
Gross profit	130,000	72,000	50,000
Distribution costs	(9,000)	(7,000)	(5,000)
Administrative expenses	(12,000)	(8,000)	(7,200)
Profit from operations	109,000	57,000	37,800
Investment income	20,300	500	500
Finance cost	(8,000)	(5,000)	(3,200)
Profit before tax	121,300	52,500	35,100
Income tax expense	(27,000)	(16,800)	(8,600)
Net profit for the period	94,300	35,700	26,500
Other comprehensive income for the period	Nil	Nil	Nil
Total comprehensive income for the period	94,300	35,700	26,500
Summarised Statements of Changes in Equity			
Balance at 1 April 2008	232,000	121,000	92,000
Comprehensive income for the period	94,300	35,700	26,500
Dividends paid on 31 December 2008	(26,000)	(20,000)	(15,000)
Balance at 31 March 2009	300,300	136,700	103,500

Note 1 – purchase of shares in Beta

On 1 October 2005 Alpha purchased a 60% equity shareholding in Beta. Alpha paid $45 million cash for this shareholding. The directors of Alpha estimated that the fair value of the non-controlling interest in Beta on 1 October 2005 was $30 million. It is Alpha's policy to value the non-controlling interest at the date of acquisition at fair value in its consolidated financial statements.

The equity of Beta as shown in its own financial statements at 1 October 2005 was $62 million. At that date Beta owned a property with a book value of $20 million and a market value of $28 million. The directors of Alpha estimated that:

– $16 million of the market value of $28 million related to the buildings element of the property, and
– the useful economic life of the buildings was 32 years from 1 October 2005.

The individual financial statements of Beta have included an annual depreciation charge of $350,000 on this property since its purchase. All depreciation is charged on a monthly basis and presented in cost of sales.

Note 2 – purchase of shares in Gamma

On 1 August 2008 Alpha purchased 42% of the equity shares of Gamma. This purchase allowed Alpha to exercise a significant influence over Gamma but Alpha was not able to control its operating and financial policies. No material differences between the market value and the book value of the net assets of Gamma were apparent at the date of the share purchase.

Note 3 – impairment reviews

An impairment review at 31 March 2009 indicated that 20% of the goodwill on acquisition of Beta needed to be written off. Apart from this, no other impairments of goodwill on acquisition of Beta have been required.

No impairment of the investment in Gamma has yet been necessary.

All impairments are charged to cost of sales.

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Note 4 – purchase of shares in Lambda

On 1 October 2008 Alpha purchased shares in Lambda, a key supplier. The shareholding did not give Alpha sole control, joint control, or significant influence over the operating and financial policies of Lambda. The directors of Alpha designated this investment as an Available for Sale financial asset. The investment is shown at its cost of $20 million in the financial statements of Alpha. On 28 February 2009 Alpha received a dividend of $1.5 million from Lambda and included this amount in investment income. The fair value of Alpha's shareholding in Lambda at 31 March 2009 was $22 million.

Note 5 – inter-company sales

Beta supplies products to Alpha and Gamma. Sales of the products to Alpha and Gamma during the year ended 31 March 2009 were as follows (all sales were made at a mark-up of 25% on cost):

– Sales to Alpha $15 million.
– Sales to Gamma (all since 1 August 2008) $6 million.

At 31 March 2009 and 31 March 2008 the inventories of Alpha and Gamma included the following amounts in respect of goods purchased from Beta.

	Amount in inventory at	
	31 March 2009	31 March 2008
	$'000	$'000
Alpha	3,300	1,700
Gamma	2,500	Nil

Note 6 – dividend payments

The dividends received from Gamma and Lambda during the period were credited to the income statement of Alpha as the post-acquisition profits of Gamma and Lambda were in excess of the dividends received.

Required:

(a) Prepare the consolidated statement of comprehensive income for Alpha for the year ended 31 March 2009. (19 marks)

(b) Prepare the consolidated statement of changes in equity for Alpha for the year ended 31 March 2009. Ignore deferred tax. (6 marks)

(25 marks)

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Section B – THREE questions ONLY to be attempted

2 The trial balance of Delta at 31 March 2009 (its financial reporting date) was as follows:

	$'000	$'000
Revenue (Note 1)		234,000
Production costs (Note 2)	120,000	
Distribution costs	11,000	
Administrative expenses	31,000	
Inventory at 31 March 2008	64,540	
Interest paid on interest bearing borrowings (Note 4)	5,000	
Income tax (Note 5)	120	
Dividends paid on equity shares	6,000	
Property, plant and equipment (Note 6):		
At cost at 31 March 2009	147,000	
Accumulated depreciation at 31 March 2008		24,660
Trade receivables	66,000	
Cash and cash equivalents	39,000	
Trade payables		24,000
Long-term interest bearing borrowings (Note 4)		100,000
Deferred tax (Note 5)		9,000
Issued equity capital		60,000
Retained earnings at 31 March 2008		38,000
	489,660	489,660

Notes to the Trial Balance

Note 1 – revenue

On 1 April 2008 Delta sold goods for a price of $22 million and credited $22 million to revenue. The terms of the sale required Delta to provide two years servicing of the goods at no additional cost. The directors of Delta estimated that the annual cost of providing the servicing would be $3 million. Delta would normally expect to make a gross profit of 25% on servicing activities

Note 2 – production costs

During the year ended 31 March 2009 Delta supplied goods to a number of different customers that they later discovered to be faulty. These goods had not been supplied in earlier periods and Delta ceased selling them prior to 31 March 2009. The customers have jointly taken legal action against Delta, claiming total damages of $12 million. Delta's legal advisers have provided the following estimates of the likely outcome:

– There is a 10% chance that all cases can be successfully defended.
– There is a 25% chance that the total damages will be $4 million.
– There is a 45% chance that the total damages will be $8 million.
– There is a 20% chance that the total damages will be $12 million.

In the draft financial statements the directors have made a provision of $7 million (10% x nil) + (25% x $4 million) + (45% x $8 million) + (20% x $12 million). They have debited this amount to production costs and included an equivalent amount in trade payables.

Note 3 – inventory at 31 March 2009

The carrying value of inventory at cost at 31 March 2009 was $67·5 million. This amount includes faulty components (see note 2 above) at their cost of $3 million. The directors of Delta estimate that these components can be modified at a cost of $600,000 and then sold for $1·8 million.

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Note 4 – long-term interest bearing borrowings

On 1 April 2008 Delta borrowed $100 million at an annual interest rate of 5%. The interest is payable annually in arrears and the principal amount of $100 million is repayable on 31 March 2013. As an alternative to repayment the investors can elect to convert their loans into equity shares on 31 March 2013. The annual market interest rate on non-convertible loans at 1 April 2008 was 8%. Discount factors are as follows:

	Annual discount factor	
	5%	**8%**
Present value of $1 payable in 5 years	78 cents	68 cents
Cumulative present value of $1 payable at the end of years 1–5	$4·33	$3·99

Note 5 – tax

– The estimated income tax on the profits for the year to 31 March 2009 is $11·5 million.
– During the year $10·3 million was paid in full and final settlement of income tax on the profits for the year ended 31 March 2008. The statement of financial position at 31 March 2008 had included $10·18 million in respect of this liability.
– At 31 March 2009 the carrying amounts of the net assets of Delta exceeded their tax base by $38 million. This information is before taking account of the property revaluation (see Note 6 below).
– The rate of income tax in the jurisdiction in which Delta operates is 25%.

Note 6 – property, plant and equipment

Details are as follows:

	Property		Plant and equipment
	Land	**Buildings**	
	$'000	**$'000**	**$'000**
Cost at 31 March 2009 (but see below)	42,000	48,000	57,000
Estimate of useful economic life (at date of purchase)	Indefinite	50 years	4 years
Accumulated depreciation at **31 March 2008**	0	9,600	15,060

On 31 March 2009 the open market value of the property was $110 million. The directors wish to reflect this revaluation in the financial statements but no entries regarding the revaluation have yet been made.
No assets were fully depreciated at 31 March 2009. All of the depreciation is to be charged to cost of sales.

Required:

(a) Prepare the statement of comprehensive income for Delta for the year ended 31 March 2009. (13 marks)

(b) Prepare the statement of financial position for Delta as at 31 March 2009 (12 marks)

Note: notes to the statements are not required.

(25 marks)

3 Epsilon is a listed entity. You are the financial controller of the entity and its consolidated financial statements for the year ended 31 March 2009 are being prepared. The board of directors is responsible for all key financial and operating decisions, including the allocation of resources. Your assistant is preparing the first draft of the statements. He has a reasonable general accounting knowledge but is not familiar with the detailed requirements of all relevant financial reporting standards. There are two issues on which he requires your advice and he has sent you a note as shown below:

Issue 1

We intend to apply IFRS 8 – *Operating Segments* – in this year's financial statements. I am aware that this standard has attracted a reasonable amount of critical comment since it was issued in November 2006.

The board of directors receives a monthly report on the activities of the five significant operational areas of our business. Relevant financial information relating to the five operations for the year to 31 March 2009, and in respect of our Head Office, is as follows:

Operational area	Revenue for year to 31 March 2009 $'000	Profit/(loss) for year to 31 March 2009 $'000	Assets at 31 March 2009 $'000
A	23,000	3,000	8,000
B	18,000	2,000	6,000
C	4,000	(3,000)	5,000
D	1,000	150	500
E	3,000	450	400
Sub-total	49,000	2,600	19,900
Head office	Nil	Nil	6,000
Entity total	49,000	2,600	25,900

I am unsure of the following matters regarding the reporting of operating segments:

– How do we decide on what our operating segments should be?
– Should we report segment information relating to Head Office?
– Which of our operational areas should report separate information? Operational areas A, B and C exhibit very distinct economic characteristics but the economic characteristics of operational areas D and E are very similar.
– Why has IFRS 8 attracted such critical comment?

(11 marks)

Issue 2

I note that on 31 January 2009 the board of directors decided to discontinue the activities of a number of our subsidiaries. This decision was made, I believe, because these subsidiaries did not fit into the long-term plans of the group and the board did not consider it likely that the subsidiaries could be sold. This decision was communicated to the employees on 28 February 2009 and the activities of the subsidiaries affected were gradually curtailed starting on 1 May 2009, with an expected completion date of 30 September 2009. I have the following information regarding the closure programme:

(a) All the employees in affected subsidiaries were offered redundancy packages and some of the employees were offered employment in other parts of the group. These offers had to be accepted or rejected by 30 April 2009. On 31 March 2009 the directors estimated that the cost of redundancies would be $20 million and the cost of relocation of employees who accepted alternative employment would be $10 million. Following 30 April 2009 these estimates were revised to $22 million and $9 million respectively.

(b) Latest estimates are that the operating losses of the affected subsidiaries for the six months to 30 September 2009 will total $15 million.

(c) A number of the subsidiaries are leasing properties under non-cancellable operating leases. I believe that at 31 March 2009 the present value of the future lease payments relating to these properties totalled $6 million. The cost of immediate termination of these lease obligations would be $5 million.

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(d) The carrying values of the freehold properties owned by the affected subsidiaries at 31 March 2009 totalled $25 million. The estimated net disposal proceeds of the properties are $29 million and all properties should realise a profit.

(e) The carrying value of the plant and equipment owned by the affected subsidiaries at 31 March 2009 was $18 million. The estimated current disposal proceeds of this plant and equipment is $2 million and its estimated value in use (including the proceeds from ultimate disposal) is $1.8 million.

I am unsure regarding a number of aspects of accounting for this decision by the board. Please tell me how the decision to curtail the activities of the three subsidiaries affects the financial statements.

(14 marks)

Required:

Draft a reply to the questions raised by your assistant.

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

(25 marks)

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4 IAS 19 – Employee benefits – is applied to all employee benefits other than those to which IFRS 2 – Share-based payment – applies. Accounting for short-term employee benefits is relatively straightforward. However, accounting for post-employment benefits can be rather more complex. This particularly applies where post-employment benefits are provided via defined benefit plans.

Required:

Explain:

(a) The meaning of post-employment benefits and the manner in which such benefits that are provided via defined contribution plans should be measured and recognised in the financial statements of employers. (3 marks)

(b) Why accounting for post-employment benefits provided via defined benefit plans is more complex than those provided via defined contribution plans in the financial statements of employers. (2 marks)

(c) The amounts that should be included in the financial statements of employers regarding post-employment benefits provided via defined benefit plans (ignore the effect of actuarial gains and losses at this stage). (6 marks)

Kappa provides post-employment benefits to its employees through a defined benefit plan. The following data relates to the plan:

	Year ended 31 March	
	2009	2008
	$'000	$'000
Present value of obligation at year end	36,000	33,000
Fair value of plan assets at year end	31,000	30,000
Current service cost	6,000	5,700
Benefits paid by plan	8,000	7,500
Contributions paid into plan	5,800	5,600
Discount rate at the start of the year	10%	9%
Expected rate of return on plan assets at the start of the year	7%	6%
Average remaining service lives of participating employees	20 years	20 years

On 1 April 2008 Kappa had net unrecognised actuarial losses of $4·2 million. Kappa accounts for actuarial gains and losses using the 'corridor method'.

Required:

(d) Prepare extracts from Kappa's statement of financial position at 31 March 2009 and from its income statement for the year ended 31 March 2009 relating to the defined benefits plan. (11 marks)

(e) Explain the various alternatives to the 'corridor approach' that IAS 19 allows for recognising actuarial gains and losses. (3 marks)

(25 marks)

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Question 5 begins on page 10.

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5 In the year ended 31 March 2009, Omega carried out the following two transactions:

(a) Transaction 1

On 1 May 2008 Omega began to lease some land. The lease was for 50 years and was correctly assessed by Omega to be an operating lease. The annual lease rentals were \$400,000, payable on 30 April in arrears. However, during its negotiations with Omega, the lessor agreed to a two-year rent free period at the start of the lease. Therefore the first payment is not due until 30 April 2011 and Omega will make only 48, rather than 50, payments.

Omega intended to build a factory on this land and on 1 June 2008 borrowed \$8 million at an annual interest rate of 9% to partly finance its construction. Construction commenced on 1 July 2008 and Omega incurred the following costs from that date:

– Construction materials purchased totalled \$5·5 million. They should have only needed materials costing \$5 million but materials costing \$0·5 million were wasted during the construction period due to an error by the construction team.
– The construction team were paid at the rate of \$800,000 per month throughout the construction period.
– It is the policy of Omega to allocate general administrative costs to all projects to ensure that their profitability can be accurately assessed. The amount of such costs that were allocated to the factory construction was \$250,000 per month, using Omega's standard cost allocation model.
– The factory was completed on 31 October 2008 and began production on 1 January 2009. In the two-month period from 31 October 2008 to 1 January 2009 Omega spent \$500,000 publicising the new factory and arranged for an opening ceremony to take place on 1 January 2009 at a cost of \$100,000. The directors estimate that the factory will generate economic benefits for Omega until 30 April 2058.

Required:

(i) Compute the amounts that will be included in the income statement for the year ended 31 March 2009 in respect of the lease of the land. Your figures should be supported by appropriate explanations.
(4 marks)

(ii) Compute the carrying amount of the factory in the statement of financial position at 31 March 2009. Your figures should be supported by appropriate explanations, both for amounts you include and for amounts you exclude. (9 marks)

(b) Transaction 2

On 1 January 2009 Omega signed a contract to supply a customer with a large item of plant and equipment that was expected to take eight months to manufacture. Omega began construction immediately. The fixed price payable to Omega on completion and delivery was agreed at \$6 million. If the machine is completed to the specified standard and delivered to the customer before 31 August 2009 then Omega would receive a bonus payment of \$1 million. Latest estimates are that the machine will be completed half-way through August 2009 and delivered before 31 August 2009. However, there is a 15% chance that delivery could be delayed until after 31 August 2009. Relevant costs relating to the contract were as follows:

– On 1 January 2009 Omega purchased materials costing \$2 million to use in the construction work.
– Salaries of staff employed on the construction of the machine totalled \$200,000 per full month from 1 January 2009.
– Construction staff used tools that had a carrying value of \$4·2 million on 1 April 2008 and an estimated future useful economic life of five years from that date, with no residual value. It is expected that throughout the construction period these tools will only be used on this contract. However, both before and after the construction period the tools are used for other purposes.
– Omega has an insurance policy to protect it against claims arising on its construction contracts. The directors estimate that a monthly premium of \$50,000 can reasonably be allocated to this contract, together with general administrative overheads of \$40,000 per month.

After the year end the directors of Omega obtained an independent assessment of the stage of completion of the contract at 31 March 2009. The results were that the contract was 40% complete at that date. In accordance with the terms of the contract, Omega invoiced the customer for a progress payment of $1·8 million on 30 April 2009 and the customer paid this amount to Omega on 31 May 2009.

Required:

Explain, with relevant calculations, how the contract would be treated in the financial statements of Omega for the year ended 31 March 2009. (12 marks)

(25 marks)

End of Question Paper

Diploma in International Financial Reporting

Thursday 9 December 2010

Time allowed
Reading and planning: 15 minutes
Writing: 3 hours

This paper is divided into two sections:

Section A – This ONE question is compulsory and MUST be attempted

Section B – THREE questions ONLY to be attempted

Do NOT open this paper until instructed by the supervisor.
During reading and planning time only the question paper may be annotated. You must NOT write in your answer booklet until instructed by the supervisor.
This question paper must not be removed from the examination hall.

The Association of Chartered Certified Accountants

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DipIFR 10 Dec Questions

Section A – This ONE question is compulsory and MUST be attempted

1 Alpha holds investments in three entities, Beta, Gamma and Foster. The statements of financial position of Alpha, Beta and Gamma at 30 September 2010 were as follows:

	Alpha $'000	Beta $'000	Gamma $'000
ASSETS			
Non-current assets:			
Property, plant and equipment (Note 1)	165,000	100,000	100,000
Intangible assets (Note 1)	Nil	12,000	Nil
Investments (Notes 1–3)	50,000	Nil	Nil
	215,000	112,000	100,000
Current assets:			
Inventories (Note 4)	65,000	37,000	30,000
Trade receivables (Note 5)	35,000	32,000	32,000
Cash and cash equivalents	10,000	7,000	8,000
	110,000	76,000	70,000
Total assets	325,000	188,000	170,000
EQUITY AND LIABILITIES			
Equity			
Share capital ($1 shares)	80,000	60,000	60,000
Retained earnings	140,000	56,000	54,000
Total equity	220,000	116,000	114,000
Non-current liabilities:			
Long-term borrowings	35,000	30,000	20,000
Contingent consideration (Note 1)	20,000	Nil	Nil
Deferred tax	15,000	10,000	10,000
Total non-current liabilities	70,000	40,000	30,000
Current liabilities:			
Trade and other payables	30,000	24,000	20,000
Short-term borrowings	5,000	8,000	6,000
Total current liabilities	35,000	32,000	26,000
Total equity and liabilities	325,000	188,000	170,000

Note 1 – Alpha's investment in Beta:

On 1 October 2009 Alpha acquired 45 million shares in Beta. The terms of the business combination were that:

– Alpha issued three new shares in Alpha to the previous shareholders of Beta for every five acquired in Beta. On 1 October 2009 the market value of a share in Alpha was $3·60 and the market value of a share in Beta was $1·90. The share issue was **not** recorded in the financial statements of Alpha.

– A further payment of $1·00 per share acquired will be made to the previous shareholders of Beta on 1 January 2012 provided the profits of Beta in the two years immediately after the acquisition exceed a target level. On 1 October 2009 the fair value of this potential additional payment was $20 million. By 30 September 2010 the fair value had risen to $24 million due to changes in circumstances since the date of acquisition. The investments of Alpha include $20 million in respect of this potential further payment.

Beta is located in a jurisdiction that uses locally developed accounting standards to prepare financial statements. The retained earnings of Beta at 1 October 2009, measured under these standards, were $44 million. These standards are identical to International Financial Reporting Standards (IFRS) in all respects other than the recognition criteria for intangible assets. None of the intangible assets of Beta would have qualified for recognition under IFRS, either at 1 October 2009 or 30 September 2010. The financial statements of Beta that are given in this question are prepared

DipIFR 10 Dec Questions

under local accounting standards. The carrying value of the intangible assets in the financial statements of Beta at 1 October 2009 was $11 million.

The directors of Alpha carried out a fair value exercise to measure the identifiable assets and liabilities of Beta at 1 October 2009. The following matters emerged:

– Plant and equipment having a carrying value of $38 million had an estimated market value of $42 million. The estimated future economic life of the plant and equipment at 1 October 2009 was two years.

– Inventory having a carrying value of $10 million had a market value of $11 million. Beta sold this inventory prior to 30 September 2010.

The fair value adjustments have not been reflected in the individual financial statements of Beta.

Note 2 – Alpha's investment in Gamma:
On 1 October 2006 Alpha acquired 15 million shares in Gamma on incorporation of Gamma for a cash payment of $1 per share. Three other investors acquired 15 million shares on the same date and under the same terms. The acquisition was a strategic decision by the four investors to exercise joint control over the operating and financial policies of Gamma.

Gamma prepares its financial statements using IFRS.

Note 3 – Alpha's investment in Foster
Alpha's investment in Foster is an available for sale investment that has a fair value of $12 million at 30 September 2010. Adjustments to the fair value of available for sale investments will constitute a temporary difference for deferred tax purposes (see note 6).

Note 4 – inter-company sale of inventories
The inventories of Beta and Gamma at 30 September 2010 included components purchased from Alpha during the year at a cost of $8 million to Beta and $6·4 million to Gamma. In arriving at the selling price Alpha marked up these components by 1/3 of their total production cost. There were no outstanding amounts payable by Beta or Gamma in respect of these purchases at 30 September 2010.

Note 5 – trade receivables
On 30 September 2010 Alpha sold trade receivables with a carrying value of $25 million to a finance company. The finance company paid $20 million to Alpha and will pay the remaining balance, less a collection charge that is based on the time taken to collect the cash from the relevant customers, when the customers pay. If the customers do not pay by 31 March 2011 then any amounts advanced to Alpha are fully refundable. There is currently no indication that any of the customers will not pay in full by that date.

When accounting for this receipt Alpha debited cash with $20 million, credited trade receivables with $25 million, and charged $5 million as a finance cost in its statement of comprehensive income.

Note 6 – deferred tax
In the consolidated financial statements the accounting policy adjustment and fair value adjustments arising on the acquisition of Beta will be regarded as temporary differences for the purposes of computing deferred tax. Any unrealised profits on inter-entity trading will also be regarded as temporary differences for this purpose.

The rate of tax to apply to temporary differences is 25%. Any deferred tax debit balances can be assumed to be recoverable and offsettable against deferred tax credit balances.

Note 7 – other information
It is the group policy to value the non-controlling interest in subsidiaries at the date of acquisition at fair value. The fair value of an equity share in Beta at 1 October 2009 should be used for this purpose.

The goodwill arising on the acquisition of Beta has not suffered any impairment since 1 October 2009.

Where permitted by IFRS Alpha uses proportionate consolidation in preparing its consolidated financial statements.

Required:

Prepare the consolidated statement of financial position of Alpha at 30 September 2010.

The following mark allocation is provided as guidance for this question:

25 marks

(25 marks)

Section B – THREE questions ONLY to be attempted

2 Delta's financial statements for the year ended 30 September 2010 are being prepared and you are provided with the following trial balance at that date:

	$'000	$'000
Revenue (Note 1)		315,000
Inventories at 30 September 2009	32,000	
Raw material purchases	150,000	
Production costs	60,000	
Distribution costs	12,000	
Administrative expenses	22,000	
Lease rentals paid (Note 3)	23,000	
Property, plant and equipment:		
– at cost (Note 4)	180,000	
– accumulated depreciation at 30 September 2009 (Note 4)		35,000
Income tax account (Note 5)	400	
Deferred tax (Note 5)		7,200
Trade receivables (Note 6)	50,000	
Cash and cash equivalents	24,800	
Trade payables		30,000
Equity share capital ($1 shares)		154,000
Equity dividend paid 31 December 2009	30,000	
Retained earnings at 30 September 2009		43,000
	584,200	584,200

Notes to the trial balance

Note 1 – Revenue
On 20 September 2010 Delta signed a contract to supply a customer with inventory during November 2010. The customer paid a deposit of $5 million when the contract was signed and Delta credited this amount to revenue. Delta did not make any adjustment to inventory on 20 September 2010 as a result of receiving the deposit.

Note 2 – Inventories
On 30 September 2010 the value of the inventories at cost at Delta's premises was $40 million. This included 200,000 units of partly completed inventory that had cost $20 per unit to manufacture. The estimated costs to complete this inventory are $6 per unit and the selling costs are estimated at $1 per unit. Until recently the selling price of this product was $30 per unit. However, a competitor has developed a new product which has affected the ability of Delta to sell the product at the normal price and it is estimated that they will need to reduce the price to $22·50 per unit (selling costs unaffected) in order to be able to sell these items.

Note 3 – Lease rentals
On 1 October 2009 Delta entered into two leasing contracts:

The first contract was a contract to lease motor vehicles for a two-year period. The estimated useful economic lives of the vehicles at the start of the lease was five years. It was the responsibility of the lessor to repair and insure the vehicles. The lease contract stated that Delta should pay a deposit of $600,000 at the start of the lease followed by monthly payments of $200,000 in arrears. The lease rentals figure includes $3 million in respect of this lease. The cars were used by office staff.

The second contract was to lease a number of machines. The lease was for a four-year period, which was the estimated useful economic life of the machines. Delta is required to repair and insure the plant, which has no estimated residual value at the end of the lease. The lease rentals were set at $10 million every six months, payable in advance. The lease rentals figure included $20 million in respect of this lease. The rate of interest implicit in this lease was 5% per six-monthly period and the present value of the minimum lease payments was very close to the fair value of the assets at the inception of the lease, which was estimated at $70 million.

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Note 4 – Property, plant and equipment

	Cost	Accumulated depreciation at 30 September 2009
	$'000	$'000
Property	90,000	5,000
Plant and equipment	90,000	30,000
	180,000	35,000

(i) Depreciation of all property, plant and equipment should be charged to cost of sales. Depreciation has not yet been charged for the year.

(ii) The plant and equipment is being depreciated on a straight-line basis at 25% per annum. No disposals of property, plant and equipment occurred in the period.

(iii) The depreciable element of the property has an allocated carrying value of $50 million and is being depreciated on a straight-line basis over 50 years from the date of original purchase. On 1 October 2009 the directors of Delta revalued this property for the first time. The property had an estimated market value at 1 October 2009 of $100 million. It is further estimated that $54 million of this value relates to the depreciable element. The original estimate of the useful economic life is still considered valid.

(iv) The directors have decided not to make an annual transfer of excess depreciation on revalued assets to retained earnings.

Note 5 – income tax

(i) On 31 December 2009 Delta made full and final payment to discharge the income tax liability for the year ended 30 September 2009. The balance on the income tax account in the trial balance is the residue after making that payment.

(ii) The estimated income tax liability for the year ended 30 September 2010 is $5 million.

(iii) A transfer of $600,000 needs to be made to the deferred tax account for the period. This includes the impact of all the adjustments necessary to prepare the financial statements apart from the initial revaluation of the property (Note 4)

(iv) The rate of income tax in the jurisdiction in which Delta operates is 25%.

Note 6 – trade receivables

The closing trade receivables includes an amount of $10 million owed by a customer who experienced cash flow problems prior to the year end. Delta agreed to accept a payment of $8 million in full and final settlement of the debt and to defer the payment until 30 September 2011. Delta would expect a return of 10% on sums invested for one year.

Required:

(i) Prepare the statement of comprehensive income for Delta for the year ended 30 September 2010;

(ii) Prepare the statement of financial position for Delta as at 30 September 2010.

Note: You are not required to produce notes to the financial statements or a statement of changes in equity.

The following mark allocation is provided as guidance for this question:

25 marks

(25 marks)

DipIFR 10 Dec Questions

3 Epsilon is a listed entity. You are the financial controller of the entity and its consolidated financial statements for the year ended 30 September 2010 are being prepared. Your assistant, who has prepared the first draft of the statements, is unsure about the correct treatment of a number of transactions and has asked for your advice. Details of the transactions are given below:

Transaction (a)

On 1 October 2009 Epsilon issued 5 million loan notes that had a value of $1 per note. The issue costs were 3 cents per note. Each note holder will receive interest of 5 cents per note on 30 September of each year starting on 30 September 2010. The loan notes are repayable on 30 September 2019 at $1·20 per note. As an alternative to repayment the loan note holders can elect to exchange their notes for shares in Epsilon. On 1 October 2009 the credit rating of Epsilon was such that it would have had to offer investors in non-convertible loan notes a rate of return of 9% per annum on any investment. The impact of issue costs would increase the effective interest rate on such loan notes to 9·45%.

The following information regarding discount rates may be relevant:

Discount rate	Present value of $1 receivable at the end of year 10	Cumulative present value of $1 receivable at the end of years 1–10
5%	61 cents	$7·72
9%	42 cents	$6·42

(6 marks)

Transaction (b)

On 1 October 2009 Epsilon began to lease a property which it intended to use as office space. The lease was for a 10-year period at the end of which the property had to be returned to the lessor in its original condition.

The lease rentals were set at $800,000 per annum, payable in arrears on 30 September each year. However, as an inducement to persuade Epsilon to sign the leasing contract the lessor paid Epsilon $1 million on 1 October 2009.

Shortly after beginning to use the property Epsilon began work in altering the internal design of the property to more adequately suit its purposes. This work was completed on 31 March 2010 at a total cost of $1·2 million. It is estimated that it will cost Epsilon $600,000 to restore the property to its original condition on 30 September 2019. An appropriate risk adjusted discount rate is 10% per annum. The present value of $1 payable in 9½ years time at an annual discount rate of 10% is approximately 40·4 cents. (11 marks)

Transaction (c)

On 1 October 2003 Epsilon had purchased an equity investment in a listed entity. Epsilon purchased 1 million shares at the then quoted price of $2 per share. This shareholding does not allow Epsilon to exercise control or significant influence over the listed entity. Epsilon intended to keep the shares for their growth potential rather than treat them as part of a trading portfolio. All the shares were still held by Epsilon on 30 September 2009 and at that date their quoted price was $3·20 per share.

On 30 June 2010 Epsilon sold 600,000 of the shares for $3·60 per share. On 30 September 2010 the quoted price of the shares was $3·50 per share. (8 marks)

Required:

For each transaction prepare extracts from the financial statements for the year ended 30 September 2010. Your extracts should be supported by appropriate explanations.

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

(25 marks)

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Question 4 begins on page 8.

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4 **(a)** IAS 33 – *Earnings per share* – requires certain entities to disclose information about earnings per share (EPS) in their financial statements.

Required:

Describe:

(i) Those entities to which IAS 33 applies;
(ii) The way in which EPS (both basic and diluted) should be computed – in outline ONLY;
(iii) The numerical disclosure requirements regarding EPS for entities that have no discontinued operations;
(iv) The additional numerical disclosure requirements regarding EPS for entities that report discontinued operations. (7 marks)

(b) Kappa is a listed entity that made a profit after tax of $35 million for the year ended 30 September 2010. There were no discontinued operations. At 1 October 2009 Kappa had 70 million ordinary shares and 30 million preferred shares in issue. The preferred shares were correctly presented in equity within the statement of financial position. In the year ended 30 September 2010 Kappa declared and paid a dividend of 12 cents per share to the ordinary shareholders and 6 cents per share to the preferred shareholders.

On 31 December 2009 Kappa made a fully subscribed rights issue of two ordinary shares for every seven held at $1·35 per share. The fair value of an ordinary share at 31 December 2009 was $1·80.

Throughout the financial year Kappa had 20 million convertible loan notes on which interest of 5 cents per note was payable annually in arrears. The carrying value of the liability element of the loan note at 1 October 2009 was $23 million and the effective rate of interest was 7%. The rate of income tax in the jurisdiction in which Kappa operates is 20% and the finance cost that is charged in the statement of comprehensive income is subject to income tax at that rate.

The notes are convertible into ordinary shares from 1 October 2011 at the option of the note-holder. The conversion terms are one ordinary share for every loan note held.

Required:

Compute the basic and diluted EPS of Kappa for the year ended 30 September 2010. (8 marks)

(c) In recent years it has become increasingly common for entities to issue equity instruments in exchange for goods and services. Such transactions are collectively referred to as equity settled share based payments.

Required:

Explain:

(i) When equity settled share based payments should be recognised in financial statements;
(ii) How equity settled share based payments should be measured (distinguishing between payments to employees and payments to other parties);
(iii) Where in the statement of comprehensive income and statement of financial position equity settled share based payments should be reported. (5 marks)

DipIFR 10 Dec Questions

(d) On 1 October 2008 Kappa granted share options to 500 sales staff. The entitlement of each member of staff depended on the achievement of overall sales targets in the three-year period to 30 September 2011. Details are as follows:

– Cumulative sales less than $100 million: 100 options each.
– Cumulative sales between $100 million and $150 million: 150 options each.
– Cumulative sales more than $150 million: 200 options each.

The options had a fair value of $1·20 per option on 1 October 2008. This had increased to $1·30 per option by 30 September 2009 and by 30 September 2010 the fair value of an option was $1·35 per option.

When the options were granted and at 30 September 2009 management estimated that total sales in the three-year period would be $130 million. However, following a very good year in the year to 30 September 2010 that estimate was revised to $160 million.

Required:

Compute the charge to the statement of comprehensive income for the year ended 30 September 2010 in respect of the above arrangement and the amount included in the statement of financial position at 30 September 2010. (5 marks)

(25 marks)

DipIFR 10 Dec Questions

5 (a) Omega is an entity with a number of subsidiaries. The year end of the entity is 30 September. On 1 January 2008 Omega acquired an 80% interest in Friendly. Details of the acquisition were as follows:

- Omega acquired 800,000 shares in Friendly by issuing two equity shares for every five acquired. The fair value of an Omega share on 1 January 2008 was $4 and the fair value of a Friendly share $1·40. The costs of issue were 5 cents per share.
- Omega incurred further legal and professional costs of $100,000 that directly related to the acquisition.
- The fair values of the identifiable net assets of Friendly at 1 January 2008 were measured at $1·3 million.

Omega initially measured the non-controlling interest in Friendly at fair value. They used the market value of a Friendly share for this purpose. No impairment of goodwill arising on the acquisition of Friendly was required at 30 September 2008 or 2009.

Friendly comprises three cash generating units A, B and C. When Friendly was acquired the directors of Omega estimated that the goodwill arising on acquisition could reasonably be allocated to units A:B:C on a 2:2:1 basis. The carrying values of the assets in these cash generating units and their recoverable amounts are as follows:

Unit	Carrying value (before goodwill allocation) $'000	Recoverable amount $'000
A	600	740
B	550	650
C	450	400

Required:

(i) Compute the carrying value of the goodwill arising on acquisition of Friendly in the consolidated statement of financial position of Omega at 30 September 2010 following the impairment review.

(ii) Compute the total impairment loss arising as a result of the impairment review, identifying how much of this loss would be allocated to the non-controlling interests in Friendly. (11 marks)

(b) During the year ended 30 September 2010 Omega acquired a subsidiary, Newsub, that was located in a jurisdiction that allows individual entities to use either local accounting standards or international financial reporting standards (IFRS). In previous periods Newsub has prepared financial statements under local accounting standards. Having become part of the Omega group the directors of Newsub have decided to prepare the individual financial statements of that company using IFRS for the year ended 30 September 2010. The directors of Newsub are aware that there is a set procedure under IFRS for entities that adopt IFRS having previously used local accounting standards but they are unaware of the details.

Required:

Explain the procedure that will need to be adopted by Newsub in preparing its financial statements under IFRS for the year ended 30 September 2010 given that previous financial statements were prepared under local accounting standards. You do NOT need to describe any exceptions to the normal procedure in detail but referring to them in general terms will gain you credit. (6 marks)

(c) On 1 October 2009 Omega sold a property it owned for $90 million and leased it back on a 10-year operating lease for rentals of $8 million per annum, payable on 30 September in arrears. The carrying value of the property in the financial statements of Omega at 1 October was $55 million and its market value on that date was $70 million.

Required:

Compute the amounts that will be shown in the statement of comprehensive income for the year ended 30 September 2010 and in the statement of financial position at 30 September 2010 in respect of the sale and leaseback. (5 marks)

(d) During the year ended 30 September 2010 Omega sold a machine to a customer that proved to have a design fault. The customer has returned the machine to Omega and demanded repayment of the purchase price of \$5 million plus compensation for lost sales of \$500,000. It is highly likely that Omega will make this payment in January 2011. The directors of Omega consider it probable that the \$4·8 million of the above amount can be recovered from the original manufacturer of the machine and this amount could reasonably be expected to be received in March 2011.

Required:

Explain how both the claim and the counter-claim will be treated in the financial statements of Omega for the year ended 30 September 2010. (3 marks)

(25 marks)

End of Question Paper

DipIFR 10 Dec Questions

Dip IFR

Diploma in International Financial Reporting

Thursday 10 June 2010

Time allowed
Reading and planning: 15 minutes
Writing: 3 hours

This paper is divided into two sections:

Section A – This ONE question is compulsory and MUST be attempted

Section B – THREE questions ONLY to be attempted

Do NOT open this paper until instructed by the supervisor.
During reading and planning time only the question paper may be annotated. You must NOT write in your answer booklet until instructed by the supervisor.
This question paper must not be removed from the examination hall.

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Section A – This ONE question is compulsory and MUST be attempted

1 Alpha holds investments in two other entities, Beta and Gamma. The statements of financial position of the three entities at 31 March 2010 were as follows:

	Alpha $'000	Beta $'000	Gamma $'000
ASSETS			
Non-current assets:			
Property, plant and equipment (Note 1)	135,000	100,000	110,000
Investments (Notes 1 and 2)	139,000	15,000	Nil
	274,000	115,000	110,000
Current assets:			
Inventories (Note 4)	45,000	32,000	27,000
Trade receivables (Note 5)	50,000	34,000	35,000
Cash and cash equivalents	10,000	4,000	8,000
	105,000	70,000	70,000
Total assets	379,000	185,000	180,000
EQUITY AND LIABILITIES			
Equity			
Share capital ($1 shares)	120,000	80,000	60,000
Retained earnings	163,000	44,000	55,000
Total equity	283,000	124,000	115,000
Non-current liabilities:			
Long-term borrowings	40,000	25,000	30,000
Deferred tax	20,000	8,000	10,000
Total non-current liabilities	60,000	33,000	40,000
Current liabilities:			
Trade and other payables	30,000	22,000	20,000
Short-term borrowings	6,000	6,000	5,000
Total current liabilities	36,000	28,000	25,000
Total equity and liabilities	379,000	185,000	180,000

Note 1 – Alpha's investment in Beta:

On 1 April 2009 Alpha purchased 60 million shares in Beta for an immediate cash payment of $100 million. The retained earnings of Beta at 1 April 2009 were $35 million.

It is the group policy to value the non-controlling interest in subsidiaries at the date of acquisition at fair value. The fair value of an equity share in Beta at 1 April 2009 was estimated at $1·70. This fair value is considered by the directors of Alpha to be an appropriate basis for measuring the non-controlling interest in Beta on 1 April 2009.

The terms of the business combination provide for the payment of an additional $15 million to the former shareholders of Beta on 31 March 2011. On 1 April 2009 Alpha's credit rating was such that it could have borrowed funds at an annual finance cost of 8%. The statement of financial position of Alpha includes this investment at its original cost of $100 million.

DipIFR 10 June Questions

The directors of Alpha carried out a fair value exercise to measure the identifiable assets and liabilities of Beta at 1 April 2009. The following matters emerged:

– A property having a carrying value of $40 million (depreciable amount $24 million) had a fair value of $60 million (depreciable amount $36 million). The estimated future economic life of the depreciable amount of the property at 1 April 2009 was 30 years.
– Plant and equipment having a carrying value of $51 million had a fair value of $54 million. The estimated future economic life of the plant at 1 April 2009 was three 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 tax to apply to temporary differences is 30%.

The goodwill arising on acquisition of Beta has not suffered any impairment since 1 April 2009.

Note 2 – Alpha's investment in Gamma:
On 1 October 2009 Alpha paid $39 million for 30% of the equity shares of Gamma. This investment gave Alpha significant influence over Gamma. The retained earnings of Gamma on 1 October 2009 were $60 million. You can ignore any deferred taxation implications of the investment by Alpha in Gamma. The investment in Gamma has not suffered any impairment since 1 October 2009.

Note 3 – Beta's investment:
Beta's investment is a strategic equity investment in Sigma – key supplier. This investment does not give Beta control or significant influence over Sigma. Sigma is not a joint venture for Beta. The investment in Sigma is correctly classified as available for sale and on 1 April 2009 was included in the financial statements of Beta at its fair value of $15 million. The fair value of the investment in Sigma on 31 March 2010 was $17 million. In the tax jurisdiction in which Beta is located unrealised profits on the revaluation of equity investments are not subject to current tax. Any such profits are taxed only when the investment is sold.

Note 4 – Inter-company sale of inventories:
The inventories of Beta and Gamma at 31 March 2010 included components purchased from Alpha during the year at a cost of $10 million to Beta and $12 million to Gamma. Alpha generated a gross profit margin of 25% on the supply of these components. You can ignore any deferred tax implications of the information in this note.

Note 5 – Trade receivables and payables:
The trade receivables of Alpha included $5 million receivable from Beta and $4 million receivable from Gamma in respect of the purchase of components (see Note 4). The trade payables of Beta and Gamma do not include any amounts payable to Alpha. This is because on 29 March 2010 Beta and Gamma paid $5 million and $4 million respectively to Alpha to eliminate the balances. Alpha received and recorded these payments on 2 April 2010.

Required:

Prepare the consolidated statement of financial position of Alpha at 31 March 2010.

The following mark allocation is provided as guidance for this question:

25 marks

(25 marks)

DipIFR 10 June Questions

Section B – THREE questions ONLY to be attempted

2 Delta's financial statements for the year ended 31 March 2010 are being prepared and you are provided with the following trial balance at that date:

	$'000	$'000
Revenue (Note 1)		350,000
Inventories at 31 March 2009	36,400	
Raw material purchases	180,000	
Production costs	70,000	
Distribution costs	10,000	
Administrative expenses	30,000	
Research and development expenditure (Note 3)	4,100	
Property, plant and equipment:		
– at cost (Note 4)	200,000	
– accumulated depreciation at 31 March 2009 (Note 4)		60,000
Finance cost of long-term borrowing	4,800	
Income tax account (Note 5)		300
Deferred tax (Note 5)		6,000
Trade receivables (Note 6)	100,000	
Cash and cash equivalents	34,500	
Trade payables		60,000
Long-term borrowings at 6% repayable 2014		80,000
Equity share capital ($1 shares)		100,000
Equity dividend paid 31 December 2009	31,000	
Retained earnings at 31 March 2009		44,500
	700,800	700,800

Notes to the trial balance

Note 1 – Revenue:
On 29 March 2010 Delta sold goods for a total sales price of $7·5 million. The goods were sold by Delta at a mark-up of 25% on cost. The goods were supplied on a sale or return basis – the return period expiring on 30 June 2010. It was not possible to accurately estimate the extent to which these customers would exercise their rights to return the goods. Delta has treated this transaction as a normal sale and eliminated the goods from inventories. Trade receivables includes $7·5 million in respect of this transaction.

Note 2 – Inventories:
On 31 March 2010 the value of the inventories at cost at Delta's premises was $40 million.

Note 3 – Research and development expenditure:
On 1 April 2009 Delta commenced a project investigating a new production technique that would significantly reduce wastage. A team of 50 staff were employed on the project and the total annual salary cost of this team was $2 million, accruing evenly over the year. Other direct costs of the design and testing of the new technique were $200,000 per month from 1 April 2009 to 31 December 2009 and $100,000 per month in January, February and March 2010.

By 30 June 2009 the team had developed an initial proposal and the technique was refined over the next six months, being subject to rigorous field-testing. This testing was completed on 31 December 2009 and the new production technique was approved as being technically feasible and commercially viable from that date. It was decided that the new production technique would be brought into practical use from 1 July 2010. On 31 December 2009 the directors estimated that the present value of the potential future cost savings the technique would generate were approximately $5 million.

DipIFR 10 June Questions

Note 4 – Property, plant and equipment:

	Cost	Accumulated depreciation at 31 March 2009
	$'000	$'000
Property	100,000	20,000
Plant and equipment	100,000	40,000
	200,000	60,000

(i) Depreciation of all property, plant and equipment should be charged to cost of sales. It has **not** been included in the cost of sales figure in the trial balance.
(ii) The plant and equipment is being depreciated using the diminishing balance method at $33^1/_3$% per annum. No disposals of property, plant and equipment occurred in the period.
(iii) The depreciable element of the property has an allocated cost of $40 million and is being depreciated on a straight-line basis over 40 years from the date of original purchase. On 1 April 2009 the directors of Delta revalued this property for the first time. The property had an estimated market value at 1 April 2009 of $115 million. It is further estimated that $30 million of this value relates to the depreciable element. The original estimate of the useful economic life is still considered valid.
(iv) The directors have decided to make an annual transfer of excess depreciation on revalued assets to retained earnings.

Note 5 – Income tax:
(i) On 31 December 2009 Delta made a full and final payment to discharge the income tax liability for the year ended 31 March 2009. The balance on the income tax account in the trial balance is the residue after making that payment.
(ii) The estimated income tax liability for the year ended 31 March 2010 is $8 million.
(iii) On 31 March 2010 the carrying values of the net assets of Delta exceeded their tax base by $60 million, creating a taxable temporary difference of that amount. This includes a taxable temporary difference of $35 million that arose as a result of the revaluation of the property on 1 April 2009 (see note 4 above).
(iv) The rate of corporate tax in the jurisdiction in which Delta operates is 25%.

Note 6 – Trade receivables:
On 1 March 2010 Delta sold trade receivables with an invoiced value of $25 million to a factor. The factor paid $20 million to Delta on 1 April 2010 and took over the duties of collecting the debts. The balance of $5 million (less an administrative fee of 1% of the amount advanced to Delta for every month the debts remain outstanding) will be paid to Delta when the invoices are settled. None of the outstanding debts were settled in March 2010. If the factor is unable to collect the receivables within three months the legal title on the uncollected receivables returns to Delta. When Delta received the cash from the factor they debited cash and credited trade receivables with $20 million.

Required:

(a) Prepare the statement of comprehensive income for Delta for the year ended 31 March 2010.

(b) Prepare the statement of financial position for Delta as at 31 March 2010.

Notes to the statement of comprehensive income and statement of financial position are not required.

The following mark allocation is provided as guidance for this question:

(a) 12 marks
(b) 13 marks

(25 marks)

DipIFR 10 June Questions

3 Epsilon is a listed entity preparing financial statements to 31 March each year. Details of the following complex transactions that have occurred in recent periods appear below:

(a) On 1 April 2007 Lambda, another entity, issued 200,000 bonds that had a nominal value of $100 per bond. The bonds were issued at $90 per bond and were redeemable at nominal value on 31 March 2012. Epsilon purchased all 200,000 of these bonds and intended to hold them to their maturity date. Annual interest payments of $6 per bond were due on 31 March in arrears. The effective annual rate of interest inherent in the bonds was 8·5%. Lambda paid the interest due on 31 March 2008 and 31 March 2009 in full. On 31 March 2009 it became apparent that Lambda was in financial difficulty and would be unable to make all the repayments due on the loan. An agreement was reached whereby Lambda would make reduced interest payments of $2 per bond on 31 March 2010, 2011 and 2012 and would then redeem the bonds at nominal value on 31 March 2012. On 31 March 2009 Epsilon would have required an annual effective return of 7·5% on new investments of this nature.

The reduced interest of $2 per bond was received by Epsilon on 31 March 2010. On 31 March 2010 there was every expectation that the revised future repayment terms would be adhered to by Lambda. Epsilon does not wish to measure financial instruments at fair value unless this is required by International Financial Reporting Standards.

Relevant discount factors are as follows:

Present value of $1 receivable in:

	7·5%	**8·5%**
1 year	93·0 cents	92·2 cents
2 years	86·5 cents	84·9 cents
3 years	80·5 cents	78·3 cents

Required:

Produce relevant extracts that show how the bond investment would be reported in the statement of financial position of Epsilon at 31 March 2008, 2009 and 2010 and in the statement of comprehensive income for the years ended 31 March 2008, 2009 and 2010. Provide any explanations you consider relevant. (12 marks)

(b) On 1 April 2009 Epsilon began to lease an office building on a 10-year operating lease. For the first five years of the lease the annual lease rentals were set at $400,000, payable in advance. For the second five years this annual rental is to increase to $450,000, payable in advance. On 1 April 2009 Epsilon carried out some alterations to the property involving the erection of temporary partitions to create suitable office space. The total cost of the alterations was $600,000. Under the terms of the lease the building had to be returned to the owner in its original condition. The estimated cost of removing the partitions at the end of the lease term is $300,000. A relevant risk adjusted discount rate is 5% per annum. The present value of $1 payable in 10 years at a discount rate of 5% is 61·4 cents.

Required:

Produce relevant extracts that show how this transaction would be reported in the statement of financial position of Epsilon at 31 March 2010 and in the statement of comprehensive income for the year ended 31 March 2010. Provide any explanations you consider relevant. (9 marks)

(c) On 1 October 2009 Epsilon ordered a quantity of inventory from a customer whose functional currency was the Euro. The agreed purchase price was 200,000 Euros. The inventory was delivered on 1 December 2009 and paid for on 31 January 2010. Half the inventory was sold prior to 31 March 2010. Relevant exchange rates are as follows ($s to 1 Euro):

1 October 2009 – 1·20
1 December 2009 – 1·25
31 January 2010 – 1·30
31 March 2010 – 1·35.

Epsilon made no attempt to hedge the exchange risk arising out of the purchase of inventory denominated in Euros.

Required:

Produce relevant extracts that show how this transaction would be reported in the statement of financial position of Epsilon at 31 March 2010 and in the statement of comprehensive income for the year ended 31 March 2010. Provide any explanations you consider relevant. (4 marks)

(25 marks)

DipIFR 10 June Questions

4 **(a)** Revenue is usually one of the largest numbers that appears in the financial statements of an entity. Therefore it is important to ensure that revenue is recognised and measured appropriately. IAS 18 – *Revenue* – was issued in order to provide standard accounting practice in this area.

Required:

(i) **Describe the meaning of revenue and the basis on which it should be measured under the principles of IAS 18;** (3 marks)

(ii) **Outline the criteria that need to be satisfied before revenue can be recognised under the principles of IAS 18. You should consider revenue from the sale of goods and from the rendering of services separately.** (5 marks)

(b) Kappa is an entity that prepares financial statements to 31 March each year. During the year ended 31 March 2010 the following transactions occurred:

(i) On 29 March 2010 Kappa delivered two machines to a customer. Details relating to the machines are as follows:

Machine	Construction cost	Invoiced price
	$	$
A	190,000	250,000
B	200,000	300,000

Machine A was unpacked and connected to the power supply necessary to operate the machine on 2 April 2010. As soon as this was done, the machine was able to operate immediately.

Machine B needed to be installed by an expert fitter before it was capable of operating in the intended manner. The installation process was complete, and the machine passed ready for use, on 4 April 2010.

The customer paid for both machines on 30 April 2010. (5 marks)

(ii) On 15 March 2010 Kappa transferred goods to a third party, Omicron, on a consignment basis. Omicron undertook to sell the goods on behalf of Kappa and remit the proceeds, less a commission of 10%, when the final purchaser paid Omicron for them. The invoiced value of these goods (the price payable by the **final purchaser** was $400,000). The goods cost Kappa $320,000 to manufacture. By 31 March 2010 Omicron had sold goods at an invoiced price of $240,000 and received payments of $160,000. No payment had been made to Kappa by Omicron by 31 March 2010. Since 31 March 2010 Omicron has sold the remaining goods, received all the proceeds, and remitted $360,000 ($400,000 x 90%) to Kappa. (5 marks)

(iii) On 1 April 2009 Kappa sold a property it owned to a bank for $3,000,000. The carrying value of the property at 1 April 2009 was $2,000,000, of which $1,200,000 was depreciable. The remaining useful economic life of the depreciable element was 30 years from 1 April 2009. Kappa continued to occupy the property and be responsible for its security and maintenance. The market value of the property on 1 April 2009 was $5,000,000 and it is considered unlikely that this will fall significantly in the foreseeable future. Kappa measures all its property, plant and equipment under the cost model.

The terms of the sale allowed Kappa the option to repurchase the property as follows:

- On 31 March 2010 for $3,300,000.
- On 31 March 2011 for $3,630,000.
- On 31 March 2012 for $3,993,000. (7 marks)

Required:

For each of the above transactions:

– **Explain and compute, by applying the principles of IAS 18, how much revenue should be recognised in the statement of comprehensive income for the year ended 31 March 2010.**

– **Identify and compute any other amounts relating to each transaction that will be included in the statement of comprehensive income for the year ended 31 March 2010 and the statement of financial position at 31 March 2010.**

(25 marks)

DipIFR 10 June Questions

5 Omega prepares financial statements under International Financial Reporting Standards (IFRS). In the two-year period ended 31 March 2010 the following events occurred:

(a) On 1 October 2008 Omega began the construction of a new factory. Costs relating to the factory were as follows:

Details	Amount $'000
Purchase of land on which to build the factory	20,000
Cost of levelling the land prior to beginning construction	850
Cost of materials needed to construct the factory (Note 1)	8,000
Monthly employment costs of the construction staff (Note 1)	500
Monthly amount of other overheads directly related to the construction (Note 1)	200
Payments to external advisors relating to the construction	500
Income from temporary use of part of the site as a car park during the construction period.	(250)
Costs of relocating staff to work in the new factory	400
Costs relating to the public opening of the factory (Note 2)	200

Note 1
In December 2008 a fire destroyed materials costing $500,000. The cost of these materials is included in the material figure that is given above. Construction work was suspended for two weeks because of the fire. The construction workers continued to be paid during this two-week period and other additional overheads of $40,000 were incurred in this period. These related to keeping the construction site secure during the temporary cessation of construction.

Note 2
Construction of the factory was completed on 28 February 2009 and the construction workers transferred to other projects from that date. The factory was not available for use until 31 March 2009, when the factory was inspected by local government officials (as required by local legal regulations) and certified as safe for use. The factory was not actually brought into use until 31 May 2009, following a public opening ceremony.

Note 3
The costs of construction were mainly financed by a loan of $30 million that was arranged during September 2008. The effective annual interest rate on the loan was 8%. The proceeds were invested prior to being needed to finance the construction cost and in the period ended 31 March 2009 the temporary investment produced income of $300,000.

Note 4
The depreciable element of the factory comprises the building costs. The majority of these costs have an estimated useful economic life of 40 years. However, the factory roof will need to be replaced after 20 years. The estimated cost of replacing the roof at current prices is $2·4 million.

Note 5
Omega computes its depreciation charge on a monthly basis and measures property, plant and equipment using the cost model.

Note 6
No impairment of the factory had occurred by 31 March 2010.

Required:

Compute the carrying value of the factory in the statement of financial position of Omega at 31 March 2010. You should support your computations with appropriate explanations of the amount you have included for the cost of the factory and for its subsequent depreciation. (17 marks)

DipIFR 10 June Questions

(b) On 31 December 2009 the directors of Omega decided to dispose of two properties in different locations. Both properties were actively marketed by the directors from 1 January 2010 and sales are expected before the end of July 2010.

Summary details of the two properties are as follows:

Property	Carrying amount at 31 March *2009* $'000	Depreciable amount at 31 March *2009* $'000	Estimated future economic life at 31 March *2009* $'000	Estimated fair value less costs to sell at 31 December *2009* $'000
A	25,000	15,000	30 years	28,000
B	22,000	16,000	40 years	18,000

Property A was available for sale without modifications from 1 January 2010 onwards. On 31 March 2010 the directors of Omega were reasonably confident that a sale could be secured for $28 million. However, after the year-end property prices in the area in which property A is located started to decline. This was due to an unexpected adverse local economic event in April 2010. Following this event the directors of Omega estimated that property A would now be sold for $22 million less selling costs and they are very confident that this lower price can be achieved.

Property B needed repair work carried out on it before a sale could be completed. This repair work was carried out in the two-week period beginning 10 April 2010. The costs of this repair work are reflected in the estimated fair value less costs to sell figure for property B of $18 million (see above). This estimate remains valid.

Required:

Compute:

- **The carrying values of both properties in the statement of financial position of Omega at 31 March 2010.**
- **The amounts charged to the statement of comprehensive income in respect of both properties for the year ended 31 March 2010.**

You should support your computations with appropriate explanations of the treatments you have adopted.

(8 marks)

(25 marks)

End of Question Paper

DipIFR 10 June Questions

Diploma in International Financial Reporting

Dip IFR

Tuesday 13 December 2011

Time allowed

Reading and planning: 15 minutes
Writing: 3 hours

ALL FOUR questions are compulsory and MUST be attempted.

Do NOT open this paper until instructed by the supervisor.

During reading and planning time only the question paper may be annotated. You must NOT write in your answer booklet until instructed by the supervisor.

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

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The question paper begins on page 3.

DipIFR 11 Dec Questions

ALL FOUR questions are compulsory and MUST be attempted

1 Alpha holds investments in Beta and Gamma. The statements of financial position of the three entities at 30 September 2011 were as follows:

	Alpha $'000	Beta $'000	Gamma $'000
ASSETS			
Non-current assets:			
Property, plant and equipment (Note 1)	210,000	165,000	120,000
Investments:			
– in Beta (Note 1)	180,000	Nil	Nil
– in Gamma (Note 3)	52,000	Nil	Nil
– in Sigma (Note 6)	15,000	Nil	Nil
	457,000	165,000	120,000
Current assets:			
Inventories (Note 4)	65,000	36,000	29,000
Trade receivables (Note 5)	55,000	38,000	35,000
Cash and cash equivalents	12,000	7,000	9,000
	132,000	81,000	73,000
Total assets	589,000	246,000	193,000
EQUITY AND LIABILITIES			
Equity			
Share capital ($1 shares)	180,000	100,000	60,000
Retained earnings	183,000	67,000	64,000
Other components of equity	90,000	5,000	Nil
Total equity	453,000	172,000	124,000
Non-current liabilities:			
Contingent consideration (Note 1)	20,000	Nil	Nil
Long-term borrowings (Note 8)	50,000	35,000	30,000
Deferred tax	15,000	9,000	12,000
Total non-current liabilities	85,000	44,000	42,000
Current liabilities:			
Trade and other payables	34,000	23,000	21,000
Short term borrowings	17,000	7,000	6,000
Total current liabilities	51,000	30,000	27,000
Total equity and liabilities	589,000	246,000	193,000

Note 1 – Alpha's investment in Beta

On 1 April 2010 Alpha acquired 80 million shares in Beta by means of a share exchange. Alpha issued one share for every two shares acquired in Beta. On 1 April 2010 the market value of an Alpha share was $4 and the market value of a Beta share was $1·80. The terms of the business combination provide for an additional cash payment to the former shareholders of Beta on 30 June 2012 based on its post-acquisition financial performance in the first two years since acquisition. The fair value of this additional payment was $20 million on 1 April 2010. The post acquisition performance of Beta was such that the fair value of this payment had increased to $22 million by 30 September 2011. The investment in Beta and the non-current liabilities of Alpha at 30 September 2010 include $20 million in respect of the additional payment due to be made on 30 June 2012.

On 1 April 2010 the individual financial statements of Beta showed the following reserves balances:

– Retained earnings $41 million.
– Other components of equity $3 million.

The directors of Alpha carried out a fair value exercise to measure the identifiable assets and liabilities of Beta at 1 April 2010. The following matters emerged:

– A property, having a carrying amount of $50 million (depreciable amount $30 million), had a fair value of $70 million (depreciable amount $33 million). The estimated future economic life of the depreciable amount of the property at 1 April 2010 was 30 years. This property was still held by Beta at 30 September 2011.
– Plant and equipment, having a carrying amount of $60 million, had an estimated market value of $64 million. The estimated future economic life of the plant at 1 April 2010 was four years. This plant was still held by Beta at 30 September 2011.
– Inventory, having a carrying amount of $30 million, had an estimated market value of $31 million. All of this inventory had been sold since 1 April 2010.

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 tax to apply to temporary differences (where required but see notes 3, 4, 6 and 7 below) is 20%.

It is the group policy to value the non-controlling interest in subsidiaries at the date of acquisition at fair value. The fair value of an equity share in Beta at 1 April 2010 can be used for this purpose.

Note 2 – Impairment reviews – Beta

On 1 April 2010 the directors of Alpha identified that Beta comprised five cash-generating units and allocated the goodwill arising on acquisition equally across each unit. No impairment of goodwill was apparent in the year ended 30 September 2010.

During the year ended 30 September 2011 four of the five cash-generating units performed very satisfactorily and no impairment of the goodwill allocated to these units had occurred. However the performance of the other unit was below expectations. During the impairment review carried out at 30 September 2011 assets (excluding goodwill) having a carrying amount in the consolidated financial statements of $50 million were allocated to this unit. The recoverable amount of these assets was estimated at $52 million.

Note 3 – Alpha's investment in Gamma

On 1 October 2010 Alpha paid $52 million for 40% of the equity shares of Gamma. The retained earnings of Gamma on 1 October 2010 were $60 million. You can ignore any deferred taxation implications of the investment by Alpha in Gamma. The investment in Gamma has not suffered any impairment since 1 October 2010.

Note 4 – Inter-company sale of inventories

The inventories of Beta and Gamma at 30 September 2011 included components purchased from Alpha during the year at a cost of $16 million to Beta and $10 million to Gamma. Alpha generated a gross profit margin of 25% on the supply of these components. You can ignore any deferred tax implications of the information in this note.

Note 5 – Trade receivables and payables

The trade receivables of Alpha included $5 million receivable from Beta and $4 million receivable from Gamma in respect of the purchase of components (see Note 4). The trade payables of Beta and Gamma included equivalent amounts payable to Alpha.

Note 6 – Alpha's investment in Sigma

Alpha's investment in Sigma does not give Alpha sole control, joint control or significant influence. The investment was purchased on 1 January 2011 for $15 million. The investment was classified as fair value through other comprehensive income. The fair value of the investment in Sigma on 30 September 2011 was $16 million. In the tax jurisdiction in which Alpha is located unrealised profits on the revaluation of equity investments are not subject to current tax. Any such profits are taxed only when the investment is sold.

DipIFR 11 Dec Questions

Note 7 – Employees share option scheme

On 1 October 2009 Alpha granted 5,000 share options to 1,000 key employees. The options are due to vest on 30 September 2013 provided the employees remain in employment at 30 September 2013. On 1 October 2009 the directors of Alpha estimated that 90% of the key employees would satisfy the vesting condition. Actual employee turnover was such that this estimate was revised to 92% on 30 September 2010 and 93% on 30 September 2011.

At 1 October 2009 the fair value of each share option was estimated to be $1·20. This estimate was revised to $1·25 on 30 September 2010 and $1·28 on 30 September 2011. You can ignore the deferred tax implications of the information in this note.

Alpha correctly recognised this transaction in the financial statements for the year ended 30 September 2010. However, they have made no additional adjustments in the financial statements for the year ended 30 September 2011.

Note 8 – Long-term borrowings

On 1 October 2010 Alpha issued 50 million loan notes of $1 each at par. The annual interest payable on these notes is 5 cents per note, payable in arrears. The notes are redeemable at par on 30 September 2015 or convertible (at the option of the note-holders) into equity shares on that date. On 1 October 2010 investors in loan notes with no conversion option would have required an annual rate of return of 8%. On 1 October 2010 the directors of Alpha included $50 million in long-term borrowings in respect of the loan notes. The actual interest paid of $2·5 million was charged as a finance cost in Alpha's income statement for the year ended 30 September 2011.

Relevant discount factors are as follows:

	5%	8%
Present value of $1 payable at the end of year 5	78·4 cents	68·1 cents
Cumulative present value of $1 payable at the end of years 1-5	$4·33	$3·99

Note 9 – Modification of vehicles

On 1 January 2011 legislation was passed requiring Alpha to carry out modifications to its motor vehicles to enable harmful emissions to be reduced. The modifications should have been completed by 30 June 2011 at an estimated cost to Alpha of $3 million. In fact by 30 September 2011 none of the vehicles had been modified although they continued to be used. It is likely that Alpha will be fined $500,000 per month for the illegal use of the vehicles. The directors of Alpha are uncertain exactly when they will carry out the modifications but they intend to do so sometime during the year ended 30 September 2012. They expect that a fine will become payable very shortly as legal action has commenced against Alpha.

Required:

Prepare the consolidated statement of financial position of Alpha at 30 September 2011.

(40 marks)

DipIFR 11 Dec Questions

2 Kappa is an entity that prepares consolidated financial statements to 30 September each year. Below are details of two events ((a) and (b)) that occurred during the year ended 30 September 2011, followed by some questions concerning their treatment in the financial statements for the year. The financial statements are due to be authorised for issue on 20 December 2011.

(a) On 31 July 2011, the directors decided to discontinue the business of one of Kappa's wholly owned subsidiaries, Lambda. They decided to cease production on 31 October 2011, with a view to disposing of the property, plant and equipment soon after 30 November 2011, the date scheduled for the completion of the sale of all Lambda's inventory and the settlement of all liabilities due to its suppliers and employees. Any amounts still owing by Lambda's customers at 30 November 2011 would be collected by other group companies on Lambda's behalf.

On 15 August 2011, the directors made a public announcement of their intentions and offered the employees of Lambda termination payments or alternative employment opportunities elsewhere in the group. Relevant financial details are as follows:

– On 31 July 2011, the directors estimated that termination payments to employees would total $10 million and, although full details are not yet available, the costs of re-training employees who would remain employed by other group companies is expected total $1 million. Actual termination costs paid out on 30 November 2011 were $10·5 million and the latest estimate of total re-training costs is $800,000.

– Lambda was leasing a property under an operating lease that expires on 31 December 2020. On 30 September 2011 the present value of the future lease rentals (using an appropriate discount rate) was $4 million. On 30 November 2011 Lambda made a payment to the lessor of $3·8 million in return for early termination of the lease. There were no rental payments made in October or November 2011.

– The loss after tax of Lambda for the year ended 30 September 2011 was $12 million. Lambda made further operating losses totalling $5 million for the two month period 1 October 2011 to 30 November 2011.

– At 30 September 2011, the property, plant and equipment of Lambda had a carrying amount of $20 million ($12 million for its owned property and $8 million for its plant and equipment) and a recoverable amount of $22 million ($17 million for its owned property and $5 million for its plant and equipment). The carrying amount of $20 million is after deducting a full year's depreciation.

A number of questions have arisen from the decision to discontinue.

Required:

(i) Is any provision for closure costs necessary and if so for what amount?

(ii) How should the decision to discontinue the business of Lambda be presented on the consolidated statement of comprehensive income?

(iii) What is the correct carrying amount for the property, plant and equipment? Should it be presented as non-current assets held for sale given that we know it was sold after the year end?

Note: You should provide any supporting explanations you consider relevant.

The following mark allocation is provided as guidance for this requirement:

(i) 6 marks
(ii) 4 marks
(iii) 2 marks

(12 marks)

DipIFR 11 Dec Questions

(b) On 1 July 2011, another wholly-owned subsidiary, Epsilon, signed a contract to manufacture a machine for a customer for a fixed price of $12 million. The customer paid a deposit of $3 million on 1 July 2011 and the balance is payable upon completion and delivery of the machine. This is expected to take place on 31 December 2011. Relevant financial details are as follows:

– Epsilon has purchased materials costing $5 million for use on the contract. $4 million of these materials had been used by the year end.

– The manufacture of the machine started on 1 August 2011 and was completed on 30 November 2011. During this period certain property, plant and equipment of Epsilon was used exclusively in the manufacturing process. Annual depreciation on this property, plant and equipment is $3 million.

– Epsilon incurred direct labour costs and other production overheads totalling $300,000 per month throughout the manufacturing period.

– General administrative overheads of $150,000 per month were allocated to the contract using Epsilon's normal cost allocation model.

– Epsilon determines the extent of completion of construction contracts by comparing the costs incurred on the contract to date with the total expected contract costs.

There are two key questions that have arisen in relation to the above outlined contract.

Required:

(i) How much revenue and profit on this contract should be reported in the statement of comprehensive income?

(ii) How should the contract be reported in the statement of financial position?

Note: You should provide any supporting explanations you consider relevant.

The following mark allocation is provided as guidance for this requirement:

(i) 6 marks
(ii) 2 marks

(8 marks)

(20 marks)

DipIFR 11 Dec Questions

3 **(a)** IAS 19 – *Employee benefits* – is a comprehensive standard that deals with the financial reporting of short and long-term employee benefits. The most complex type of employee benefit dealt with in IAS 19 is post-employment benefits. Such benefits are usually provided via a separate plan into which the employer makes contributions. The impact of such arrangements on the financial statements of contributing employers depends on the type of retirement benefit plan.

One of the particularly complex aspects of the standard is the treatment of actuarial gains and losses arising on the measurement of obligations relating to post-employment benefits. IAS 19 allows a number of alternative treatments.

Required:

You are required to provide an explanation of:

(i) The difference between a defined contribution and a defined benefit plan. Your explanation should include an analysis of which party bears the risks attaching to the level of benefits.

(ii) The difference, in the financial statements of contributing employers, between the method of accounting for contributions to defined contribution plans and contributions to defined benefit plans.

(iii) The two alternative ways other than the corridor method of reporting actuarial gains and losses arising in respect of defined benefit plans.

The following mark allocation is provided as guidance for this requirement:

(i) 3 marks
(ii) 3 marks
(iii) 2 marks

(8 marks)

(b) Omicron prepares financial statements to 30 September each year. Omicron makes contributions to a defined benefit post-employment benefit plan for its employees. Omicron accounts for actuarial gains and losses arising on these arrangements using the corridor method. Relevant data is as follows:

(i) At 1 October 2010 the plan obligation was $35 million and the fair value of the plan assets was $30 million. Unrecognised actuarial losses at that date totalled $6·5 million.

(ii) The actuary advised that the current service cost for the year ended 30 September 2011 was $4 million. Omicron paid contributions of $3·2 million to the plan on 30 September 2011. These were the only contributions paid in the year.

(iii) The expected annual rate of return on plan assets at 1 October 2010 was 5%. The actuary revised this estimate to 4% at 30 September 2011.

(iv) The appropriate annual rate at which to discount the plan liabilities was 6% on 1 October 2010 and 5·5% on 30 September 2011.

(v) The plan paid out benefits totalling $2 million to retired members on 30 September 2011.

(vi) At 30 September 2011 the plan obligation was $41·5 million and the fair value of the plan assets was $32·5 million.

(vii) The average remaining service lives of plan members still in employment was estimated to be 20 years.

Required:

Compute the amounts that will appear in the statement of comprehensive income of Omicron for the year ended 30 September 2011 and the statement of financial position at 30 September 2011 in respect of the post-employment benefit plan.

Note: You should indicate where in each statement the relevant amounts will be presented. (12 marks)

(20 marks)

4 You are the financial controller of Omega. Omega has subsidiaries located in a number of different countries. Omega has a strategy of growth by acquisition and regularly evaluates potential acquisition targets from different countries and financial reporting regimes. Omega regularly seeks to raise capital on a number of different markets to fund new acquisitions. All subsidiaries currently prepare financial statements using applicable local accounting standards. The consolidated financial statements have been prepared using local accounting standards that apply in Omega's jurisdiction up to and including the year ended 30 September 2011. Local regulations allow financial statements to be prepared either using local accounting standards or International Financial Reporting Standards (IFRS). The directors are giving serious consideration to using IFRS from the year ending 30 September 2012 onwards. One of the directors is unsure of the wisdom of this proposal and has identified a number of issues about which he is uncertain.

Issue (a)
Changing from using local standards to using international standards is bound to have short-term cost implications. I need to be convinced that the benefits of a change justify these costs. Please describe **three** ways we would benefit from a move to IFRS. (6 marks)

Issue (b)
Before I can agree with a move to IFRS I need to understand how the standard setting process works. Someone told me there are **four** different bodies involved! Please give me a brief description of each one of these, highlighting their role in the standard setting process. (8 marks)

Issue (c)
I'm unclear about the practicalities of adopting IFRS in the year ending 30 September 2012. I've heard that we need to start with the opening IFRS statement of financial position. I'm unclear what this means and for what date it is prepared. Please explain the process for me, including any additional disclosures we need to make in the first set of financial statements prepared under IFRS. (6 marks)

Required:

Prepare a response to the three issues raised by the director.

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

(20 marks)

End of Question Paper

Diploma in International Financial Reporting

Thursday 9 June 2011

Time allowed
Reading and planning: 15 minutes
Writing: 3 hours

ALL FOUR questions are compulsory and MUST be attempted.

Do NOT open this paper until instructed by the supervisor.

During reading and planning time only the question paper may be annotated. You must NOT write in your answer booklet until instructed by the supervisor.

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

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 The income statements and summarised statements of changes in equity of Alpha, Beta and Gamma for the year ended 31 March 2011 are given below:

Income Statements

	Alpha	Beta	Gamma
	$000	$000	$000
Revenue	470,000	434,000	226,000
Cost of sales	(256,000)	(218,000)	(176,000)
Gross profit	214,000	216,000	50,000
Distribution costs	(18,000)	(17,000)	(15,000)
Administrative expenses	(19,000)	(16,000)	(17,000)
Investment income (Note 5)	37,300	Nil	Nil
Finance cost (Note 6)	(68,000)	(65,000)	(44,000)
Profit/(loss) before tax	146,300	118,000	(26,000)
Income tax expense	(41,000)	(33,000)	Nil
Profit/(loss) for the year	105,300	85,000	(26,000)

Summarised Statements of Changes in Equity

	Alpha	Beta	Gamma
Balance at 1 April 2010	540,000	390,000	192,000
Comprehensive income for the year	105,300	85,000	(26,000)
Dividends paid on 31 December 2010	(52,000)	(40,000)	Nil
Balance at 31 March 2011	593,300	435,000	166,000

Note 1 – purchase of shares in Beta

On 1 October 2009 Alpha purchased 75 million of the 100 million equity shares in Beta. Details of the share purchase were as follows:

– Alpha issued two new equity shares for every three shares acquired in Beta. On 1 October 2009 the market value of an Alpha share was $6 and the market value of a Beta share was $3·20.

– Alpha agreed to make an additional cash payment of $1 for every share acquired in Beta to be paid on 30 September 2011. This payment is contingent on the profits of Beta exceeding a cumulative target in the two-year period ending 30 September 2011. The fair value of this contingent payment was $55 million on 1 October 2009. The fair value had risen to $58 million by 31 March 2010 and to $64 million by 31 March 2011. The directors of Alpha correctly accounted for this contingent consideration in its financial statements for the year ended 31 March 2010 but no changes have been made to the carrying value of the contingent consideration since 31 March 2010.

– Alpha incurred legal and professional costs of $5 million connected with the acquisition; $2·4 million of these costs related to the cost of issuing shares. Alpha correctly accounted for these acquisition costs in its financial statements for the year ended 31 March 2010.

Alpha decided to value the non-controlling interest in Beta at the date of acquisition at fair value in its consolidated financial statements. The market value of a Beta share at that date was used to calculate the fair value of the non-controlling interest.

The equity of Beta as shown in its own financial statements at 1 October 2009 was $300 million. At that date the property, plant and equipment (PPE) of Beta had a carrying value of $240 million and a fair value of $280 million. The estimated future useful economic life of the PPE of Beta was four years from 1 October 2009. No disposals of PPE occurred between 1 October 2009 and 31 March 2011.

On 1 October 2009 the directors estimated that the internally generated brand name of Beta had a fair value of $30 million and a future useful economic life of 30 years.

All depreciation and amortisation is charged on a monthly basis and presented in cost of sales.

Note 2 – impairment review

On 31 March 2010 and 31 March 2011 the goodwill on consolidation of Beta was reviewed for impairment. No impairment of the goodwill was necessary as a result of the review on 31 March 2010. Beta is regarded as a single cash generating unit for impairment purposes and at 31 March 2011 its recoverable amount was estimated as $550 million. Any impairment of goodwill is charged to cost of sales.

Note 3 – purchase of shares in Gamma

On 1 October 2010 Alpha purchased 40% of the equity shares of Gamma for $75 million in cash. This purchase allowed Alpha to exercise a significant influence over Gamma. No material differences between the market value and the book value of the net assets of Gamma were apparent at the date of the share purchase. On 31 March 2011 an impairment review was conducted resulting in an impairment required of $1·8 million.

Note 4 – inter-company sales

Beta supplies products to Alpha and Gamma. Sales of the products to Alpha and Gamma during the year ended 31 March 2011 were as follows (all sales were made at a mark-up of $33^1/_3$% on cost):

– Sales to Alpha $18 million.
– Sales to Gamma $12 million.

At 31 March 2011 and 31 March 2010 the inventories of Alpha and Gamma included the following amounts in respect of goods purchased from Beta.

	Amount in inventory at	
	31 March 2011	31 March 2010
	$000	$000
Alpha	3,600	2,100
Gamma	2,700	Nil

Note 5 – Equity investments

At 1 April 2010 Alpha had two equity investments that it designated as fair value through other comprehensive income in accordance with IFRS 9 *Financial Instruments*. At the date of acquisition:

Name	Original cost	Fair value at 31 March 2010	2011
	$000	$000	$000
Delta	12,000	15,000	n/a
Epsilon	11,000	14,000	15,400

On 31 January 2011 Alpha disposed of its investment in Delta for $19·5 million and showed a profit on sale of $4·5 million ($19·5 million – $15 million) as part of investment income. Apart from recording the receipt of dividend income no other entries have been made in the financial statements for the year ended 31 March 2011 regarding the investment in Epsilon. Both investments had been correctly treated in the financial statements for the year ended 31 March 2010.

Note 6 – Convertible notes

On 1 April 2010 Alpha issued 300 million loan notes of $1 per note at par. The loan notes entitled the holders to an interest payment of 5 cents per note, payable annually in arrears. The loan notes are repayable at par on 31 March 2015. As an alternative to repayment the holders can elect to convert the notes into equity shares in Alpha. On 1 April 2010 investors in non-convertible notes would expect an annual return of 8%. You are given the following discount factors:

Discount rate	Present value of $1 payable At the end of year 5	Cumulatively at the end of years 1–5
5%	78·4 cents	$4·33
8%	68·1 cents	$3·99

On 1 April 2010 the directors of Alpha recorded a loan liability of $300 million and in the year ended 31 March 2011 a finance cost of $15 million (300 million x 5 cents) in respect of these notes.

DipIFR 11 June Questions

Note 7 – Environmental damage

During the year ended 31 March 2011 Alpha began production at three newly acquired factories. The normal production process at each factory results in environmental damage. Alpha has a policy of only rectifying such damage when legally required to do so. Details of the damage caused at the three sites up to and including 31 March 2011 are as follows:

Factory	Damage caused by 31 March 2011	Clean-up legislation in place at 31 March 2011?
	$000	
A	3,000	Yes
B	1,000	No
C	2,000	No but legislation passed since year end with retrospective effect

No provision for environmental damage has been made in the financial statements. Any appropriate provision should be reported as part of cost of sales.

Required:

(a) Prepare the consolidated statement of comprehensive income for Alpha for the year ended 31 March 2011; (33 marks)

(b) Prepare the summarised consolidated statement of changes in equity for Alpha for the year ended 31 March 2011. Your summarised statement should include a column for the non-controlling interest. (7 marks)

Ignore deferred tax.

(40 marks)

DipIFR 11 June Questions

2 Kappa is a listed entity that prepares financial statements to 31 March each year. Below are details of two transactions of the entity:

Transaction one

On 31 January 2010 Kappa signed a contract with a fuel company to purchase a large quantity of fuel for its own use. The fuel was delivered and paid for on 30 April 2010. The supplier's functional currency is the Euro and the contracted price was 500,000 euros. Kappa's functional currency is the dollar. In order to protect Kappa from exchange fluctuations, on 31 January 2010 the directors entered into a forward contract to purchase 500,000 euros for 700,000 dollars on 30 April 2010.

The dollar strengthened against the euro between 31 January 2010 and 31 March 2010 and on 31 March 2010 the contract to purchase 500,000 euros for 700,000 dollars had a value of 20,000 dollars (financial liability). The dollar strengthened further during April 2010 and on 30 April 2010, when the spot exchange rate was 1·35 dollars = 1 euro, Kappa made a payment of 25,000 dollars to settle the forward contract. The fuel was delivered in accordance with the terms of the contract and used evenly in the 12 month period from 1 May 2010 to 30 April 2011. The directors wish to use cashflow hedge accounting where this is permitted by International Financial Reporting Standards. You can assume that the contract to purchase the euros was a perfectly effective hedge of the potential exchange fluctuations arising out of the contract to purchase the fuel. (10 marks)

Transaction two

On 1 April 2009 Kappa began to lease an office block on a 20-year lease. The useful economic life of the office buildings was estimated at 40 years on 1 April 2009. The supply of leasehold properties exceeded the demand on 1 April 2009 so as an incentive the lessor paid Kappa $1 million on 1 April 2009 and allowed Kappa a rent-free period for the first two years of the lease, followed by 36 payments of $250,000, the first being due on 1 April 2011.

Between 1 April 2009 and 30 September 2009 Kappa carried out alterations to the office block at a total cost of $3 million. The terms of the lease require Kappa to vacate the office block on 31 March 2029 and leave it in exactly the same condition as it was at the start of the lease. The directors of Kappa have consistently estimated that the cost of restoring the office block to its original condition on 31 March 2029 will be $2·5 million at 31 March 2029 prices.

An appropriately risk-adjusted discount rate for use in any discounting calculations is 6% per annum. The present value of $1 payable in 19½ years at an annual discount rate of 6% is 32 cents. (10 marks)

Required:

Prepare extracts from the financial statements for both transactions that show their impact on:

(a) The statements of financial position at 31 March 2010 and 2011;

(b) The statements of comprehensive income for the years ended 31 March 2010 and 2011.

In both cases your extracts should be supported by appropriate explanations and computations.

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

(20 marks)

DipIFR 11 June Questions

3 (a) IAS 38 – *Intangible assets* – deals with the recognition and subsequent measurement of intangible assets.

Required:

Explain the following:

(i) The meaning of the term 'intangible asset' and those intangible assets that are within the scope of IAS 38;

(ii) The criteria that need to be satisfied before expenditure can be recognised as an intangible asset under IAS 38;

(iii) How recognised intangible assets should be subsequently measured. (9 marks)

(b) Lambda is a listed entity that prepares consolidated financial statements. Lambda measures assets using the revaluation model wherever this is possible under International Financial Reporting Standards. During its financial year ended 31 March 2011 Lambda entered into the following transactions:

(i) On 1 October 2009 Lambda began a project to investigate a more efficient production process. Expenses relating to the project of $2 million were charged in the statement of comprehensive income in the year ended 31 March 2010. Further costs of $1·5 million were incurred in the three-month period to 30 June 2010. On that date it became apparent that the project was technically feasible and commercially viable. Further expenditure of $3 million was incurred in the six-month period from 1 July 2010 to 31 December 2010. The new process, which began on 1 January 2011, was expected to generate cost savings of at least $600,000 per annum over the 10-year period commencing 1 January 2011.

(ii) On 1 April 2010 Lambda acquired a new subsidiary, Omicron. The directors of Lambda carried out a fair value exercise as required by IFRS 3 – *Business Combinations* – and concluded that the brand name of Omicron had a fair value of $10 million and would be likely to generate economic benefits for a ten-year period from 1 April 2010. They further concluded that the expertise of the employees of Omicron contributed $5 million to the overall value of Omicron. The estimated average remaining service lives of the Omicron employees was eight years from 1 April 2010.

(iii) On 1 October 2010 Lambda renewed its licence to extract minerals that are needed as part of its production process. The cost of renewal of the licence was $200,000 and the licence is for a five-year period starting on 1 October 2010. There is no active market for this type of licence. However, the directors of Lambda estimated that at 31 March 2011 the fair value less costs to sell of the licence was $175,000. They further estimated that over the remaining 54 months of its duration the licence would generate net cash flows for Lambda that had a present value at 31 March 2011 of $185,000.

Requirements:

Assuming the Lambda group has no intangible assets other than those mentioned above, compute the carrying value of intangible assets in the consolidated statement of financial position of Lambda as at 31 March 2011. You should provide relevant explanations to support your figures. You are NOT required to compute the goodwill arising on acquisition of Omicron. (11 marks)

(20 marks)

DipIFR 11 June Questions

4 You are given details of three transactions affecting the financial statements of Omega:

Transaction One

On 1 April 2009 Omega granted share options to 20 senior executives. The options are due to vest on 31 March 2012 provided the senior executives remain with the company for that period. The number of options vesting to each director depends on the cumulative profits over the three-year period from 1 April 2009 to 31 March 2012:

- 10,000 options per director if the cumulative profits are between $5 million and $10 million.
- 15,000 options per director if the cumulative profits are more than $10 million.

On 1 April 2009 and 31 March 2010 the best estimate of the cumulative profits for the three-year period ending on 31 March 2012 was $8 million. However, following very successful results in the year ended 31 March 2011, the latest estimate of the cumulative profits in the relevant three-year period is $14 million.

On 1 April 2009 it was estimated that all 20 senior executives would remain with Omega for the three-year period, but on 31 December 2009 one senior executive left unexpectedly. None of the other executives have since left and none are expected to leave before 31 March 2012.

A further condition for vesting of the options is that the share price of Omega should be at least $12 on 31 March 2012. The share price of Omega over the last two years has changed as follows:

- $10 on 1 April 2009.
- $11·75 on 31 March 2010.
- $11·25 on 31 March 2011.

On 1 April 2009 the fair value of the share options granted by Omega was $4·80 per option. This had increased to $5·50 by 31 March 2010 and $6·50 by 31 March 2011.

Required:

(a) Produce extracts, with supporting explanations, from the statements of financial position at 31 March 2010 and 2011 and from the statements of comprehensive income for the years ended 31 March 2010 and 2011 that show how transaction one will be reflected in the financial statements of Omega.

Note: Ignore deferred tax. (8 marks)

Transaction Two

On 1 April 2009 Omega purchased ten new machines for $12 million each. Each machine had an overall estimated useful economic life of 10 years. The estimated residual value of each machine was zero. Each machine will require a substantial overhaul after five years in order to maintain its operating capacity and the cost of such an overhaul at 1 April 2009 prices was $3 million per machine. In the year ended 31 March 2010 Omega charged total depreciation of $12 million on the machines but the directors have subsequently realised that this may have been an error that could have a material impact on the financial statements.

Required:

(b) Produce extracts, with supporting explanations, from the statements of comprehensive income for the years ended 31 March 2010 and 2011 and from the statement of changes in equity for the year ended 31 March 2011 that show how transaction two will be reflected in the financial statements of Omega.

Note: Ignore deferred tax. (5 marks)

Transaction Three

On 1 June 2010 Omega signed a contract to construct a machine for one of its customers and to subsequently provide servicing facilities relating to the machine. Omega commenced construction on 1 July 2010 and the construction took two months to complete. Omega incurred the following costs of construction:

– Materials $1 million.
– Other direct costs $2 million.
– Allocated fixed production overheads $1 million. This allocation was made using Omega's normal overhead allocation model.

On 1 October 2010 the machine was delivered to the customer. The customer paid the full contract price of $7·5 million on 30 November 2010. The servicing and warranty facilities are for a three-year period from 1 October 2010. This is not considered to be an onerous contract at 31 March 2011. In the six-month period from 1 October 2010 to 31 March 2011 Omega incurred costs of $200,000 relating to the servicing and this rate of expenditure is estimated to continue over the remainder of the three-year period. Omega would normally expect to earn a profit margin of 20% on the provision of servicing facilities of this nature.

Required:

(c) Produce extracts, with supporting explanations, from the statement of financial position at 31 March 2011 and from the statement of comprehensive income for the year ended 31 March 2011 that show how transaction three will be reflected in the financial statements of Omega.

Note: Ignore deferred tax. (7 marks)

(20 marks)

End of Question Paper

DipIFR 11 June Questions

Diploma in International Financial Reporting

Tuesday 11 December 2012

Time allowed
Reading and planning: 15 minutes
Writing: 3 hours

ALL FOUR questions are compulsory and MUST be attempted.

Do NOT open this paper until instructed by the supervisor.

During reading and planning time only the question paper may be annotated. You must NOT write in your answer booklet until instructed by the supervisor.

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

The Association of Chartered Certified Accountants

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ALL FOUR questions are compulsory and MUST be attempted

1 The statements of comprehensive income of Alpha, Beta and Gamma for the year ended 30 September 2012 are given below:

Statements of comprehensive income

	Alpha $'000	Beta $'000	Gamma $'000
Revenue	240,000	150,000	120,000
Cost of sales	(190,000)	(110,000)	(70,000)
Gross profit	50,000	40,000	50,000
Distribution costs	(7,000)	(6,000)	(8,000)
Administrative expenses	(10,000)	(7,000)	(8,000)
Profit from operations	33,000	27,000	34,000
Investment income	15,300	Nil	Nil
Finance cost	(8,000)	(4,900)	(7,300)
Profit before tax	40,300	22,100	26,700
Income tax expense	(10,100)	(6,000)	(6,700)
Net profit for the period	30,200	16,100	20,000
Other comprehensive income	4,000	Nil	Nil
Total comprehensive income	34,200	16,100	20,000

Note 1 – Purchase of shares in Beta

On 1 October 2011, Alpha purchased 80% of the equity shares of Beta. The purchase consideration was as follows:

– Alpha issued 32 million shares to the shareholders of Beta. The market price of an Alpha share on 1 October 2011 was $2·50.

– Alpha agreed to make an additional payment of $30 million to the shareholders of Beta on 30 September 2013. This payment was contingent on the post-acquisition profits of Beta reaching a specified level in the two-year period ending on 30 September 2013. The directors of Alpha assessed that the fair value of this contingent consideration was $20 million on 1 October 2011 and debited $20 million to the cost of investment in Beta. They reassessed the fair value of the contingent consideration at $22 million on 30 September 2012. The increase in the fair value of the contingent consideration was caused by the better than expected performance of Beta in the post-acquisition period. The directors of Alpha made no change to the carrying value of the cost of investment in Beta as a result of this reassessment.

– Alpha incurred incremental legal and professional fees of $1·5 million in connection with the acquisition of Beta and debited these costs to the cost of investment in Beta. $500,000 of this amount related to the costs of issuing the Alpha shares.

Note 2 – Fair value exercise

The directors of Alpha carried out a fair value exercise on the net assets of Beta on 1 October 2011. On 1 October 2011, the equity of Beta as shown in its own financial statements was $88 million. The fair values of the net assets of Beta were the same as their book values with the exception of:

– Plant and equipment that had a book value of $80 million and a fair value of $84 million. The estimated remaining useful economic life of this plant and equipment was two years at 1 October 2011. Depreciation of plant and equipment is charged to cost of sales.

– An intangible asset that had a fair value of $6 million but was not recognised by Beta because it was internally developed. The useful life of this asset was estimated at 18 months from 1 October 2011. Amortisation of intangible assets is charged to cost of sales.

– Inventory that had a book value of $3 million and a fair value of $3·2 million. All this inventory was sold in the year ended 30 September 2012.

– The fair value adjustments are temporary differences that attract deferred tax at a rate of 25%.

Note 3 – Basis of measurement of non-controlling interests

It is the policy of Alpha to measure non-controlling interests based on their fair value at the date of acquisition. The estimated fair value of the non-controlling interest in Beta at 1 October 2011 was $20 million.

Note 4 – Other information regarding Beta

– On 1 October 2011, Alpha made a loan of $40 million to Beta at a fixed annual interest rate of 5%. Both Alpha and Beta have correctly accounted for the interest on this loan in their individual statements of comprehensive income.
– On 31 March 2012, Beta paid a dividend of $10 million to its equity shareholders.

Note 5 – Impairment review

On 30 September 2012, the directors of Alpha reviewed the goodwill on acquisition of Beta for impairment. They measured the recoverable amount of Beta (as a single cash-generating unit) at $118 million at that date. Impairment of goodwill is charged to cost of sales.

Note 6 – Purchase of shares in Gamma

– On 1 January 2012, Alpha and another investor both purchased 50% of the equity capital of Gamma for a cash payment of $50 million. These investments enabled the two investors to jointly control Gamma.
– On 31 March 2012, Gamma paid a dividend of $10 million to its equity shareholders.
– The recoverable amount of the investment in Gamma by Alpha was estimated at $50 million on 30 September 2012.
– Ignore the deferred tax implications of the investment in Gamma.

Note 7 – Inter-company sales

Alpha supplies products used by Beta and Gamma. Sales of the products to Beta and Gamma during the year ended 30 September 2012 were as follows (all sales were made at a profit margin of 20%):

– Sales to Beta $25 million.
– Sales to Gamma (all since 1 January 2012) $12 million.

At 30 September 2012, the inventories of Beta and Gamma included the following amounts in respect of goods purchased from Alpha. Ignore the deferred tax implications of the inter-company sales to Beta and Gamma.

	$'000
Beta	5,000
Gamma	4,000

Note 8 – Share based payments

On 1 October 2011, Alpha granted 1,000 senior employees 2,500 share options each, provided they remained as employees for the two years ending 30 September 2013. On 1 October 2011, the fair value of one share option was $5 and this had increased to $5·40 by 30 September 2012. On 1 October 2011, the directors estimated that 950 employees would qualify for these options. At 30 September 2012, this estimate was 960 employees. Ignore the deferred tax implications of this transaction.

Note 9 – Other comprehensive income of Alpha

On 1 September 2011, Alpha entered into a contract to sell €60 million for $85 million. This contract was to hedge against an expected sales receipt from a customer on 31 January 2012 that was denominated in €. On 30 September 2011, the contract was a financial asset with a fair value of $1 million. Alpha designated the contract as a cash-flow hedge of the expected future sales in € and credited $1 million to other comprehensive income in the year ended 30 September 2011. On 31 January 2012, the sales in € were made to the customer and the customer paid for the goods on that date. On 31 January 2012, the fair value of the contract to sell €60 million for $85 million was $5 million. Therefore Alpha credited a further $4 million to other comprehensive income and recorded the sales revenue at €60 million, translated at the spot rate of exchange on that date.

Note 10 – Investment by Alpha in Zeta

On 1 October 2011, Alpha purchased 100,000 equity shares in Zeta for $10 per share. The investment did not give Alpha control or significant influence over Zeta and was designated by Alpha as fair value through other comprehensive income. Alpha incurred transaction costs of $50,000 which it recorded as part of its finance costs. During the period Alpha received a dividend of $2 per share from Zeta and at 30 September 2012 the fair value of a Zeta share was $11. Alpha recorded both the dividend and the increase in fair value of its holding as investment income. Ignore the deferred tax implications of this transaction.

Required:

Prepare the consolidated statement of comprehensive income for Alpha for the year ended 30 September 2012.

(40 marks)

2 You are the financial controller of Delta. Your assistant is preparing the first draft of the financial statements for the year ended 30 September 2012. He has a reasonable general accounting knowledge but is not familiar with the detailed requirements of all relevant international financial reporting standards. There are three issues on which he requires your advice and he has sent you a memorandum as shown below:

(a) On 1 October 2011, we lent $2 million to a supplier in order to assist them with their expansion plans. The loan cost us $100,000 to arrange, so I guess we need to charge $100,000 as a cost in the current year? We agreed not to charge interest on this loan to help our supplier's short-term cash flow but expected the supplier to repay $2·4 million on 30 September 2013. This will mean we can't take any profit this year but there will be a nice bonus next year when we receive repayment. I was told by the finance department that the effective annual rate of interest on this loan is 6·9%. I don't understand the relevance of this information as no interest is payable.

Just before the year end, I heard from the customer that the poor economic climate has caused them significant problems and in order to help them we agreed to reduce the amount repayable by them on 30 September 2013 to $2·2 million. This still means we will report a profit next year though, doesn't it? (7 marks)

(b) On 1 October 2010, we bought a large machine for $20 million. This machine has an estimated useful life of eight years, but will need a substantial overhaul on 30 September 2014 in order to enable it to be used for the final four years of its estimated life. This overhaul is likely to cost $4 million, based on prices prevailing at 1 October 2010. If the overhaul occurs, the machine is expected to have a reasonable resale value at the end of its useful life. On 1 October 2010, the estimated residual value of the machine was $1 million. On 30 September 2011, this estimate was revised to $1·1 million and on 30 September 2012, the estimate was revised to $1·2 million. For some reason we didn't charge depreciation on this asset in the year to 30 September 2011. I think this was a mistake, so I suppose I should correct this by charging two years depreciation in the current year? (8 marks)

(c) During the year ended 30 September 2012, we provided consultancy services to a customer regarding the installation of a new production system. The system has caused the customer considerable problems, so the customer has taken legal action against us for the loss of profits that has arisen as a result of the problems with the system. Our legal department considers that there is a 25% chance the claim can be successfully defended, but a 75% chance that we will be required to pay damages of $1·6 million. We shouldn't suffer any overall loss because our legal people also tell me they are reasonably confident we are covered by insurance against these types of loss. We'll make a claim as soon as the outcome of the case is confirmed. I assume nothing needs to be provided for here because we are covered but do I need any note disclosures? (5 marks)

Required:

Draft a reply to the questions raised by your assistant. Your reply should include any additional explanations you consider relevant. In all cases, you should compute the impact on the reported earnings for the year ended 30 September 2012

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

(20 marks)

DipIFR 12 Dec Questions

3 **(a)** Revenue is often the largest single amount appearing in the financial statements of an entity. In some circumstances the timing of recognition of revenue, and the measurement of its amount, can be extremely subjective. IAS 18 – *Revenue* – was published to provide guidance regarding this issue.

Required:

Explain, with regard to the guidance in IAS 18:

(i) **The criteria that need to be satisfied before revenue from the sale of goods can be recognised;** (3 marks)

(ii) **The ADDITIONAL criterion that applies to the recognition of revenue from the rendering of services;** (1 mark)

(iii) **The basis on which revenue is measured.** (2 marks)

(b) Epsilon prepares financial statements to 30 September each year. During the year ended 30 September 2012, the following transactions occurred:

(i) On 1 August 2012, Epsilon supplied motor vehicles it had manufactured to a car dealer. The normal selling price of the vehicles was $400,000 but Epsilon did not invoice the dealer at the date the vehicles were supplied, and Epsilon retained legal title to the vehicles. The terms of the transaction were that Epsilon would invoice the dealer, and transfer legal title to the vehicles, at the earlier of the date the dealer found a buyer for the vehicles or 31 January 2013. The invoiced amount would be selling price at the date of delivery plus a display charge of 1% per month (or part month) the vehicles were displayed by the dealer before they assumed legal ownership. The dealer has the right to return the vehicles to Epsilon at any time in the six months immediately following transfer, provided the vehicles are in good condition. In these circumstances, the dealer would have to pay the appropriate display charge plus an early return penalty of 50% of the normal selling price of the returned vehicle at the date of original supply by Epsilon. The dealer is responsible for any loss of, or damage to, the vehicles during the display period. On 31 August 2012, the dealer sold 25% of the vehicles supplied by Epsilon and accordingly Epsilon invoiced an amount of $101,000. The dealer paid this amount on 30 September 2012. On 30 September 2012, the dealer sold a further 20% of the supplied vehicles and Epsilon invoiced an amount of $81,608. The dealer has an established record of settling invoices by the due date for payment. (7 marks)

(ii) Epsilon provides consultancy advice to other firms in the motor industry. On 1 April 2012, Epsilon signed a contract to supply 50 days of consultancy advice to a customer over the two-year period ending on 31 March 2014. The contract required Epsilon to submit to six-monthly audits to ensure that the performance conditions in the contract had been adhered to in the immediately preceding six months. The first six-monthly audit was carried out shortly after 30 September 2012, and this confirmed that Epsilon had satisfactorily supplied 15 days of advice in the six-month period ending on that date. The total contract price was $1·5 million payable on 31 March 2014. Epsilon has strong budgetary control systems in place and is able to accurately forecast the costs incurred in delivering the consultancy. The customer has a good record of making payments when they fall due. An appropriate rate of interest to impute to this project would be 15% for an 18-month period. (7 marks)

Required:

For both transactions compute:

The total amount of revenue Epsilon should recognise in the year ended 30 September 2012.
The amount and nature of any assets relating to the transaction at 30 September 2012.

Your answer should include appropriate explanations to support your figures.

Note: The mark allocation is shown against both of the transactions above.

(20 marks)

DipIFR 12 Dec Questions

4 Omega prepares financial statements under International Financial Reporting Standards. In the year ended 30 September 2012, the following events occurred:

(a) On 1 July 2012, Omega decided to sell one of its divisions as a going concern following a recent change in its geographical focus. The proposed sale would involve the buyer acquiring the non-monetary assets (including goodwill) of the division, with Omega collecting any outstanding trade receivables relating to the division and settling any current liabilities.

On 1 July 2012, the carrying amounts of the relevant assets of the division were as follows:

– Purchased goodwill $600,000.
– Property, plant and equipment (average remaining estimated useful life two years) $2 million.
– Inventories $1 million.

From 1 July 2012, Omega began to actively market the division and has received a number of serious enquiries. On 1 July 2012, the directors estimated that they would receive $3·2 million from the sale of the division. Since 1 July 2012, market conditions have improved and on 31 October 2012 Omega received and accepted a firm offer to purchase the division for $3·3 million. The sale is expected to be completed on 31 December 2012. $3·3 million can be assumed to be a reasonable estimate of the value of the division on 30 September 2012. During the period from 1 July 2012 to 30 September 2012, inventories of the division costing $800,000 were sold for $1,200,000. At 30 September 2012, the total cost of the inventories of the division was $900,000. All of these inventories have an estimated net realisable value that is in excess of their cost.

Required:

Show how the proposed sale of the division will be reported in the financial statements of Omega for the year ended 30 September 2012, giving relevant explanations where appropriate. You should indicate the extent to which relevant transactions and balances need to be separately disclosed and when the separate disclosures can be made in the notes, rather than in the primary financial statements themselves.
(12 marks)

(b) On 1 January 2012, Omega entered into an operating lease for a piece of land on which it intended to construct a factory. The lease was for a 30-year period and was correctly assessed by Omega to be an operating lease. The lease rentals were $500,000 per half-year, payable in arrears. There was a surplus of supply of land for leasing on 1 January 2012 and so the lessor made a payment of $1·2 million to Omega on 1 January 2012 as an incentive to enter into the lease agreement.

On 1 January 2012, Omega began to construct a factory and borrowed $10 million to finance the construction. The effective rate of interest on the borrowing was 8% per annum, before tax. Omega actually spent $10·6 million on the construction materials but of this amount, $800,000 was on materials that were damaged before they were used and had to be destroyed.

The factory took six months to construct and the construction team were paid at a total amount of $750,000 per month throughout the construction period. The factory was ready for use on 1 July 2012 but production did not begin until 1 September 2012.

Required:

Show the effect of the lease of the land, and the subsequent construction of the factory, on the financial statements of Omega for the year ended 30 September 2012 (statement of financial position and statement of comprehensive income), giving relevant explanations where appropriate. (8 marks)

(20 marks)

End of Question Paper

DipIFR 12 Dec Questions

Diploma in International Financial Reporting

Tuesday 19 June 2012

Time allowed
Reading and planning: 15 minutes
Writing: 3 hours

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The question paper begins on page 3.

DipIFR 12 June Questions

ALL FOUR questions are compulsory and MUST be attempted

1 Alpha holds investments in two other entities, Beta and Gamma. The statements of financial position of the three entities at 31 March 2012 were as follows:

	Alpha $'000	Beta $'000	Gamma $'000
ASSETS			
Non-current assets:			
Property, plant and equipment (Note 1)	267,000	250,000	220,000
Investments (Notes 1 and 4)	263,349	Nil	Nil
	530,349	250,000	220,000
Current assets:			
Inventories (Note 5)	85,000	50,000	40,000
Trade receivables (Note 6)	75,000	45,000	36,000
Cash and cash equivalents	15,000	10,000	8,000
	175,000	105,000	84,000
Total assets	705,349	355,000	304,000
EQUITY AND LIABILITIES			
Equity			
Share capital ($1 shares)	195,000	100,000	80,000
Retained earnings	281,167	100,000	100,000
Other components of equity (Note 2)	Nil	55,000	Nil
Total equity	476,167	255,000	180,000
Non-current liabilities:			
Deferred consideration (Note 1)	61,983	Nil	Nil
Pension liability (Note 7)	35,000	Nil	Nil
Long-term borrowings (Note 8)	60,000	45,000	50,000
Deferred tax	21,199	15,000	20,000
Total non-current liabilities	178,182	60,000	70,000
Current liabilities:			
Trade and other payables (Note 6)	35,000	30,000	34,000
Short term borrowings	16,000	10,000	20,000
Total current liabilities	51,000	40,000	54,000
Total equity and liabilities	705,349	355,000	304,000

Note 1 – Alpha's investment in Beta

On 1 April 2010, Alpha acquired 75 million shares in Beta by means of a share exchange. The terms of the business combination were as follows:

– Alpha issued two shares for every three shares acquired in Beta. On 1 April 2010, the market value of an Alpha share was $3·50.
– Alpha will make a deferred cash payment to the former shareholders of Beta on 31 March 2013 of $1 per Beta share acquired. On 1 April 2010, Alpha's incremental borrowing rate was 10% per annum. Alpha has included a liability of $61,983,471 in respect of this deferred payment in its statement of financial position as at 31 March 2012.

It is the group policy to value the non-controlling interest in subsidiaries at the date of acquisition at fair value. The market value of an equity share in Beta at 1 April 2010 can be used for this purpose. On 1 April 2010, the market value of a Beta share was $2·00.

DipIFR 12 June Questions

On 1 April 2010, the individual financial statements of Beta showed the following reserves balances:

– Retained earnings $45 million.
– Other components of equity $35 million.

The directors of Alpha carried out a fair value exercise to measure the identifiable assets and liabilities of Beta at 1 April 2010. The following matters emerged:

– Plant and equipment having a carrying value of $100 million had an estimated market value of $110 million. The estimated future economic life of the plant at 1 April 2010 was five years and this estimate remains valid. Beta has disposed of 20% of this plant and equipment since 1 April 2010.
– Inventory having a carrying value of $35 million had an estimated market value of $38 million. This inventory had been sold since 1 April 2010.

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 tax to apply to temporary differences where required is 20%.

Note 2 – other components of equity

The other components of Beta's equity arise due to its policy of measuring property using the revaluation model. Beta revalued its property as at 1 April 2010 so the carrying value at that date in Beta's financial statements represented its fair value. Beta does not make any transfer of the revaluation surplus to retained earnings as the property is used. Beta did not revalue the property again until 31 March 2012. The depreciation charge on the property in the financial statements of Beta for the year ended 31 March 2012 was based on the carrying value of the property as at 1 April 2010. The revaluation of the property at 31 March 2012 created a gross surplus of $25 million on which Beta recognised a deferred tax liability (at 20%) of $5 million. Therefore Beta credited $20 million to other components of equity on 31 March 2012. Alpha measures its property, plant and equipment using the cost model. The policy of Alpha is to be applied in preparing the consolidated financial statements.

Note 3 – impairment reviews – Beta

On 1 April 2010, the directors of Alpha identified that Beta comprised four cash-generating units, unit 1, unit 2, unit 3 and unit 4. The directors of Alpha allocated the goodwill arising on the acquisition across the units in the ratio 2:1:1:1 respectively.

During the year ended 31 March 2012, three of the four cash-generating units performed very satisfactorily and no impairment of the goodwill allocated to these units had occurred. However, the performance of the unit 4 was below expectations. At 31 March 2012, the assets (excluding goodwill) of unit 4 had a carrying amount in the consolidated financial statements of $70 million. The recoverable amount of the assets of unit 4 at 31 March 2012 was estimated at $75 million.

Note 4 – Alpha's investment in Gamma:

On the date of incorporation of Gamma, Alpha subscribed for 40% of the equity shares of Gamma, making a payment of $32 million in cash. This investment made Gamma a joint venture. The draft financial statements of Alpha recognise this investment at cost.

You can ignore any deferred tax implications of the investment by Alpha in Gamma.

Note 5 – inter-company sale of inventories

The inventories of Beta and Gamma at 31 March 2012 included components purchased from Alpha during the year at a cost of $15 million to Beta and $12·5 million to Gamma. Alpha applied a mark-up of 25% of its production cost in arriving at the sale price of these components. You can ignore the deferred tax implications of any adjustments you make due to the information in this note.

Note 6 – trade receivables and payables

The trade receivables of Alpha included $8 million receivable from Beta and $6 million receivable from Gamma in respect of the purchase of components (see Note 5). The trade payables of Beta and Gamma included equivalent amounts payable to Alpha.

Note 7 – Employee benefits

Alpha has established a defined benefit retirement benefits plan for its employees. Its statement of financial position at 31 March 2011 showed a net liability of $60 million in respect of this plan, comprising:

– Pension obligation $140 million.
– Fair value of plan assets $80 million.

Relevant data for the plan for year ended 31 March 2012 is as follows:

– Current service cost $28 million.
– Interest cost on net plan liabilities $2 million.
– Contributions paid into the plan by Alpha $25 million.
– Benefits paid by the plan to plan members $9 million.
– Actuarial loss on net plan liabilities $1 million.

The only accounting entry made by Alpha in respect of the plan in its draft financial statements of the current period was to debit the net pension liability with the contributions paid into the plan. Actuarial gains and losses are recognised in other comprehensive income as they arise. You can ignore the deferred tax implications of any adjustments you make due to the information in this note.

Note 8 – Long-term borrowings

The long-term borrowings of Alpha arose on 1 April 2011 when Alpha borrowed €50 million. Alpha incurred issue costs of €1 million. The exchange rate at 1 April 2011 was $1·20 = €1. On 1 April 2011 Alpha included $60 million in long-term borrowings and charged $1·2 million to comprehensive income.

The borrowing requires Alpha to make annual interest payments in arrears of €4 million. The exchange rate on 31 March 2012 was $1·25 = €1. Alpha therefore charged a finance cost of $5 million to comprehensive income on 31 March 2012.

The loan is repayable by Alpha on 31 March 2016 at an amount of €58 million. The effective annual interest rate applicable to this loan is 11·1%. Other than as described in this note, Alpha has made no other accounting entries relating to this loan. You can ignore the deferred tax implications of any adjustments you make due to the information in this note.

Required:

Prepare the consolidated statement of financial position of Alpha at 31 March 2012.

(40 marks)

DipIFR 12 June Questions

2 Delta is an entity that prepares financial statements to 31 March each year. During the year ended 31 March 2012 the following events occurred:

(a) On 1 April 2011, Delta purchased some land for $10 million. Delta purchased the land in order to extract minerals from it. During the six months from 1 April 2011 to 30 September 2011, Delta incurred costs totalling $3·5 million in preparing the land and erecting extraction equipment. This process caused some damage to the land. Delta began extracting the minerals on 1 October 2011 and the directors estimate that there are sufficient minerals to enable the site to have a useful economic life of 10 years from that date. Further damage to the land is caused as the minerals are extracted.

Delta is legally obliged to rectify the damage caused by the preparation and mineral extraction. The directors estimate that the costs of this rectification on 30 September 2021 will be as follows:

(i) $3 million to rectify the damage caused by the preparation of the land.
(ii) $200,000 for each year of the extraction process to rectify damage caused by the extraction process itself.

Following this rectification work the land could potentially be sold to a third party for no less than its original cost of $10 million.

An annual discount rate appropriate for this project is 12%. The present value of $1 payable in 10 years' time with an annual discount rate of 12% is 32·2 cents. The present value of $1 payable in 9½ years' time with an annual discount rate of 12% is 34·1 cents. (9 marks)

(b) On 1 April 2011, Delta granted 20,000 share options to each of 100 senior executives. The options vest on 31 March 2014, provided the executives remain with Delta throughout the period ending on 31 March 2014 and providing the share price of Delta is at least $1·60 on that date. Relevant data relating to the share options is as follows:

Date	**Market value of:** Granted option	Delta share
1 April 2011	$0·84	$1·20
31 March 2012	$0·90	$1·28

On 1 April 2011, estimates suggested that 95 of the executives would remain with Delta throughout the period. This estimate changed to 92 executives on 31 March 2012. (5 marks)

(c) At 31 March 2012, Delta was engaged in a legal dispute with a customer who alleged that Delta had supplied faulty products that caused the customer actual financial loss. The directors of Delta consider that the customer has a 75% chance of succeeding in this action and that the likely outcome should the customer succeed is that the customer would be awarded damages of $1 million. The directors of Delta further believe that the fault in the products was caused by the supply of defective components by one of Delta's suppliers. Delta has initiated legal action against the supplier and considers there is a 70% chance Delta will receive damages of $800,000 from the supplier. Ignore discounting in this part of the question. (3 marks)

(d) On 10 April 2012, a water leak at one of Delta's warehouses damaged a consignment of inventory. This inventory had been manufactured prior to 31 March 2012 at a total cost of $800,000. The net realisable value of the inventory prior to the damage was estimated at $960,000. Because of the damage Delta was required to spend a further $150,000 on repairing and re-packaging the inventory. The inventory was sold on 15 May 2012 for proceeds of $900,000. Any adjustment in respect of this event would be regarded by Delta as material. (3 marks)

Required:

Explain and show how the four events would be reported in the financial statements of Delta for the year ended 31 March 2012.

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

(20 marks)

DipIFR 12 June Questions

3 **(a)** IFRS 5 – *Non-current Assets Held for Sale and Discontinued Operations* – deals with the measurement and reporting of assets or groups of assets that are intended to be sold or otherwise disposed of.

Required:

(i) State the criteria that need to be satisfied before an asset or disposal group is classified as held for sale under IFRS 5.

(ii) Explain how assets or disposal groups that are classified as held for sale are measured and presented in the statement of financial position. You need to describe only the minimum presentation requirements.

(iii) State the criteria that need to be satisfied before an operation is classified as discontinued under IFRS 5.

(iv) Identify the minimum amounts that need to be presented on the face of the statement of comprehensive income in respect of discontinued operations. (10 marks)

(b) Epsilon prepares financial statements to 31 March each year.

On 1 October 2011, Epsilon decided to dispose of a business component. This business component is a disposal group that satisfied the criteria for classification as held for sale at 1 October 2011. The carrying values of the relevant assets and liabilities of the component in the financial statements of Epsilon on 1 October 2011, measured individually in accordance with applicable International Financial Reporting Standards were as follows:

	$'000
Goodwill	10,000
Property, plant and equipment – estimated future useful economic life 4 years	25,000
Net current assets	5,000
	40,000

On 1 October 2011, the directors of Epsilon estimated that the fair value less costs to sell of this disposal group was $28 million. The group was disposed of on 30 April 2012 for $31 million. This was in line with a revised estimate made on 31 March 2012.

The profit after tax of the business component for the year ended 31 March 2012 was $3 million

Required:

(i) Compute the carrying amount of the goodwill and property, plant and equipment of the business component on 1 October 2011 immediately after classification as held for sale.

(ii) Compute the carrying amount of the goodwill and property, plant and equipment of the business component on 31 March 2012.

(iii) Show the minimum amounts that must be presented on the face of the statement of comprehensive income of Delta for the year ended 31 March 2012 concerning the business component.

Note: In this part, your answer should be supported by appropriate explanations. Marks will be awarded for these explanations. (10 marks)

(20 marks)

DipIFR 12 June Questions

4 Omega prepares financial statements to 31 March each year. Two of the transactions entered into during the year ended 31 March 2012 are shown below:

(a) On 1 April 2011, Omega began to lease a property on a 20-year lease. Omega paid a lease premium of \$3 million on 1 April 2011. The terms of the lease required Omega to make annual payments of \$500,000 in arrears, the first of which was made on 31 March 2012.

On 1 April 2011 the fair values of the leasehold interests in the leased property were as follows:

– Land \$3 million.
– Buildings \$4·5 million.

There is no opportunity to extend the lease term beyond 31 March 2031. On 1 April 2011 the estimated useful economic life of the buildings was 20 years.

The annual rate of interest implicit in finance leases can be taken to be 9·2%. The present value of 20 payments of \$1 in arrears at a discount rate of 9·2% is \$9.

Required:

Explain the accounting treatment for the above property lease and produce appropriate extracts from the financial statements (statement of comprehensive income and statement of financial position) of Omega for the year ended 31 March 2012. (11 marks)

(b) On 1 January 2011, Omega signed a contract to purchase a machine from a foreign supplier on 30 June 2011. The purchase price of the machine, payable in cash on 30 June 2011, was 2 million shillings. On 1 January 2011, Omega entered into a forward contract to purchase 2 million shillings on 30 June 2011 for \$1·1 million. On 31 March 2011, a contract to buy 2 million shillings on 30 June 2011 would have required a payment of \$1·2 million.

On 30 June 2011 the spot rate of exchange was 1·6 shillings = \$1. The forward contract was settled by the other party making a payment of \$150,000 to Omega on that date.

Omega estimated that the useful economic life of the machine was five years from 30 June 2011, with no residual value. Omega uses hedge accounting whenever permitted by IAS 39 – *Financial Instruments: Recognition and Measurement*. The currency contract fully complies with the criteria and conditions for hedge accounting as set out in IAS 39.

Required:

Explain the accounting treatment required for the above machine and foreign currency contract, also preparing extracts from the financial statements (statement of comprehensive income and statement of financial position) for the years ended 31 March 2011 and 31 March 2012. (9 marks)

(20 marks)

End of Question Paper

DipIFR 12 June Questions

Diploma in International Financial Reporting

Tuesday 10 December 2013

Time allowed
Reading and planning: 15 minutes
Writing: 3 hours

ALL FOUR questions are compulsory and MUST be attempted.

Do NOT open this paper until instructed by the supervisor.

During reading and planning time only the question paper may be annotated. You must NOT write in your answer booklet until instructed by the supervisor.

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

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The question paper begins on page 3.

DipIFR 13 Dec Questions

ALL FOUR questions are compulsory and MUST be attempted

1 Alpha holds investments in two other entities, Beta and Gamma. The statements of financial position of the three entities at 30 September 2013 were as follows:

	Alpha $'000	Beta $'000	Gamma $'000
ASSETS			
Non-current assets:			
Property, plant and equipment (Notes 1 and 3)	320,000	235,000	220,000
Intangible assets (Notes 1 and 4)	55,000	60,000	Nil
Investments (Notes 1 and 2)	322,000	Nil	Nil
	697,000	295,000	220,000
Current assets:			
Inventories (Note 5)	88,000	61,000	42,000
Trade receivables (Note 6)	65,000	49,000	38,000
Cash and cash equivalents	12,000	10,000	9,000
	165,000	120,000	89,000
Total assets	862,000	415,000	309,000
EQUITY AND LIABILITIES			
Equity			
Share capital ($1 shares)	195,000	150,000	120,000
Retained earnings	185,000	115,000	75,000
Other components of equity (Notes 2 and 3)	192,000	11,000	Nil
Total equity	572,000	276,000	195,000
Non-current liabilities:			
Long-term borrowings (Note 8)	170,000	54,000	50,000
Deferred tax	50,000	35,000	20,000
Total non-current liabilities	220,000	89,000	70,000
Current liabilities:			
Trade and other payables (Note 6)	48,000	45,000	34,000
Short-term borrowings	22,000	5,000	10,000
Total current liabilities	70,000	50,000	44,000
Total equity and liabilities	862,000	415,000	309,000

Note 1 – Alpha's investment in Beta

On 1 July 2012, Alpha acquired 120 million shares in Beta by means of a share exchange. The terms of the business combination were as follows:

– Alpha issued five shares for every six shares acquired in Beta. On 1 July 2012, the market value of an Alpha share was $2·40. This share issue has been correctly reflected in the financial statements of Alpha.
– Alpha will make a further cash payment of $50 million to the former shareholders of Beta on 30 June 2015. Alpha has made no entry in its financial statements in respect of this additional payment. At 1 July 2012, Alpha's credit rating was such that it could have borrowed funds at an annual interest rate of 10%.

It is the group policy to value the non-controlling interest in subsidiaries at the date of acquisition at fair value. The market value of an equity share in Beta at 1 July 2012 was $1·70 and can be used for this purpose.

On 1 July 2012, the individual financial statements of Beta showed the following reserves balances:

– Retained earnings $98 million.
– Other components of equity $5 million (see Note 3 below).

DipIFR 13 Dec Questions

The directors of Alpha carried out a fair value exercise to measure the identifiable assets and liabilities of Beta at 1 July 2012. The following matters emerged:

– Plant and equipment having a carrying value of $120 million had an estimated market value of $130 million. The estimated future economic life of the plant and equipment at 1 July 2012 was four years and this estimate remains valid. Beta has disposed of 20% of this plant and equipment since 1 July 2012.
– Intangible assets with an estimated market value of $12 million had not been recognised in the individual financial statements of Beta. At 1 July 2012, the estimated future economic lives of these intangible assets was five 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%.

No impairment of the goodwill on acquisition of Beta has occurred since 1 July 2012.

Note 2 – Alpha's investment in Gamma

On 1 October 2012, Alpha acquired 48 million shares in Gamma for a total cash payment of $80 million. This share purchase followed an agreement with two other investors (who each purchased 36 million shares in Gamma on 1 October 2012) to exercise joint control over Gamma. All key operating and financial policies, including the distribution of profits, require the unanimous consent of the three investors. In its own financial statements Alpha treated the investment in Gamma as a financial asset and made an election to measure it at fair value through other comprehensive income. On 30 September 2013, the fair value of Alpha's investment in Gamma was $82 million. Alpha did not recognise any deferred tax in respect of this restatement to fair value. Therefore on 30 September 2013 Alpha credited $2 million to other components of equity.

On 1 October 2012, the individual financial statements of Gamma showed the following reserves balances:

– Retained earnings $66 million.
– Other components of equity $Nil

On 1 October 2012, there were no material differences between the carrying values of the net assets of Gamma in the individual financial statements and the fair values of those net assets.

You do not need to consider the deferred tax implications of Alpha's investment in Gamma when preparing the consolidated statement of financial position of the Alpha group.

Note 3 – Property, plant and equipment of Beta

Beta measures its land under the revaluation model. The other components of equity of Beta consist entirely of revaluation surpluses arising on the revaluation of its land. On 1 July 2012, the carrying value of Beta's land in Beta's own financial statements was the same as its fair value. On 30 September 2013, Beta revalued its land by $7·5 million. As a result of this revaluation, Beta recognised an additional deferred tax liability of $1·5 million and credited $6 million to other components of equity. The policy of Alpha and Gamma is to use the cost model to measure all property, plant and equipment. This is the policy to be adopted in the consolidated financial statements.

Note 4 – Intangible assets of Alpha and Beta

The intangible assets of Alpha comprise expenditure incurred during the year on a project to reduce wastage incurred during the group's production processes. The project began on 1 November 2012 and is expected to be complete by 31 May 2014. Expenditure to date has been $5 million each month. On 1 June 2013, the directors were able to assess the technical feasibility and commercial viability of the project with reasonable certainty. At this date they also received assurance that the economic benefits the project was likely to bring to the group were likely to exceed the total project costs.

The intangible assets in the individual financial statements of Beta represent goodwill which arose on acquisition of an unincorporated business in 2008. No impairment of this goodwill has been necessary since the date of acquisition of Beta by Alpha.

Note 5 – Inter-company sale of inventories

The inventories of Beta and Gamma at 30 September 2013 included components produced by Alpha. The selling price of the components included in the inventories of Beta was $14 million. The selling price of the components

DipIFR 13 Dec Questions

included in the inventories of Gamma was $12 million. Alpha applied a mark up of one-third of its production cost in arriving at the sales price of these components. You can ignore deferred tax when making any adjustments due to the information in this note.

Note 6 – Trade receivables and payables

The trade receivables of Alpha included $8 million receivable from Beta and $7 million receivable from Gamma in respect of the purchase of components (see Note 5). The trade payables of Beta and Gamma included equivalent amounts payable to Alpha.

Note 7 – Forward currency contract

During July and August 2013 Alpha conducted a large marketing effort in Country X. The currency in Country X is the Euro. Alpha made no sales to customers in Country X in the year ended 30 September 2013 but is very confident of making substantial sales to such customers in the year ended 30 September 2014. On 5 September 2013, Alpha entered into a contract to sell €20 million for $28 million on 31 October 2013. Currency fluctuations in September 2013 were such that on 30 September 2013 the fair value of this currency contract was $1·1 million (a financial asset). The draft financial statements of Alpha do not include any amounts in respect of this currency contract since it has a zero cost. Alpha wishes to use hedge accounting whenever permitted by International Financial Reporting Standards. Alpha expects sales to customers in Country X to be at least €22 million in October 2013.

Note 8 – Long-term borrowings

The long-term borrowings of Alpha include a loan at a carrying amount of $60 million which was taken out on 1 October 2012. The loan does not carry any interest but $75·6 million is repayable on 30 September 2015. This represents an effective annual rate of return for the investors of 8%. As an alternative to repayment, the investors can exchange their loan asset for equity shares in Alpha on 30 September 2015. The annual rate of return required by such investors on a non-convertible loan would have been 10%. Alpha has not charged any finance cost in respect of this loan for the year ended 30 September 2013.

The present value of $1 payable/receivable in three years' time is as follows:

– 79·4 cents when the discount rate is 8% per annum.
– 75·1 cents when the discount rate is 10% per annum.

Required:

Prepare the consolidated statement of financial position of Alpha at 30 September 2013.

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

(40 marks)

DipIFR 13 Dec Questions

2 Delta is an entity which prepares financial statements to 30 September each year. Each year the financial statements are authorised for issue on 30 November. During the year ended 30 September 2013 the following transactions occurred:

(a) On 1 April 2013, Delta subscribed for 40 million \$1 loan notes in Epsilon. The loan notes were issued at 90 cents and under the terms of issue were redeemable at \$1·20 on 31 March 2018. Interest is payable on 31 March in arrears at 4% of par value. This represents an effective annual rate of return for Delta of 9·9%. Delta's intention is to hold the loan notes until redemption. Until 31 October 2013 Epsilon was a successful company with a good reputation for settling all its liabilities on their due dates. However, due to an event which occurred on 31 October 2013, three of Epsilon's major customers became insolvent and this caused liquidity problems for Epsilon. During November 2013 Epsilon entered into negotiations with all its creditors, including Delta. Delta agreed to forego the interest payments due on 31 March 2014 and 2015, with the payments from 31 March 2016 onwards resuming as normal. (8 marks)

(b) On 1 June 2013, Delta decided to dispose of the trade and assets of a business it had acquired several years previously. This disposal does not involve Delta withdrawing from a particular market sector. The carrying values on 1 June 2013 of the assets to be disposed of were as follows:

	\$m
Goodwill	10
Property, plant and equipment	20
Patents and trademarks	8
Inventories	15
Trade receivables	10
	63

Delta offered the business for sale at a price of \$46·5 million, which was considered to be reasonably achievable. Delta estimated that the direct costs of selling the business would be \$500,000. These estimates have not changed since 1 June 2013 and Delta estimates that the business will be sold by 31 March 2014 at the latest.

None of the assets of the business had suffered obvious impairment at 1 June 2013. At that date the inventories and trade receivables of the business were already stated at no more than their recoverable amounts. (7 marks)

(c) On 1 April 2013 Delta sold a property for \$20 million. The carrying amount of the property was \$23 million and its market value on 1 April 2013 was \$25 million. On 1 April 2013, Delta entered into an agreement to lease the property on a five-year lease. On that date the useful economic life of the property was estimated at 25 years. Annual lease rentals of \$1·8 million were payable on 1 April in advance. These rentals reflected the fact that the property had been sold at a price which was lower than its fair value. (5 marks)

Required:

Explain and show (where possible by quantifying amounts) how the three events would be reported in the financial statements of Delta for the year ended 30 September 2013. You do not need to quantify amounts which are only shown in the notes to the financial statements.

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

You should assume that all transactions described here are material.

(20 marks)

3 **(a)** When preparing financial statements it is important to ensure that the tax consequences of all transactions are appropriately recognised. IAS 12 – *Income Taxes* – prescribes the treatment of both current and deferred tax assets and liabilities.

Current tax is the amount of income tax payable or recoverable in respect of the taxable profit or tax loss for a period. Deferred tax is tax on temporary differences. A temporary difference is the difference between the carrying amount of an asset or liability and its tax base. A taxable temporary difference leads to a potential deferred tax liability and a deductible temporary difference leads to a potential deferred tax asset.

Required:

Explain how the tax base of both an asset and a liability is computed and state the general requirements of IAS 12 regarding the recognition of both deferred tax liabilities and deferred tax assets. You do not need to identify any of the exceptions to these general requirements which are set out in IAS 12. (5 marks)

(b) Kappa prepares consolidated financial statements to 30 September each year. During the year ended 30 September 2013 Kappa entered into the following transactions:

(i) On 1 October 2012, Kappa purchased an equity investment for $200,000. The investment was designated as fair value through other comprehensive income. On 30 September 2013, the fair value of the investment was $240,000. In the tax jurisdiction in which Kappa operates, unrealised gains and losses arising on the revaluation of investments of this nature are not taxable unless the investment is sold. Kappa has no intention of selling the investment in the foreseeable future. (5 marks)

(ii) On 1 August 2013, Kappa sold products to Omega, a wholly owned subsidiary operating in the same tax jurisdiction as Kappa, for $80,000. The goods had cost Kappa $64,000. By 30 September 2013, Omega had sold 40% of these goods, selling the remaining 60% in October and November 2013. (6 marks)

(iii) On 31 March 2013, Kappa received $200,000 from a customer. This payment was in respect of services to be provided by Kappa from 1 April 2013 to 31 January 2014. Kappa recognised revenue of $120,000 in respect of this transaction in the year ended 30 September 2013 and will recognise the remainder in the year ended 30 September 2014. Under the tax jurisdiction in which Kappa operates, the $200,000 received on 31 March 2013 was included in the taxable profits of Kappa for the year ended 30 September 2013. (4 marks)

Required:

Explain and show how the tax consequences (current and deferred) of the three transactions would be reported in the statement of financial position of Kappa at 30 September 2013 and its statement of profit or loss and other comprehensive income for the year ended 30 September 2013.

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

You should assume that:

– The rate of income tax in the jurisdiction in which Kappa operates is 25%.
– Both Kappa and Omega are profitable companies which consistently generate annual taxable profits of at least $1,000,000.

In answering this part, you do NOT need to consider the possible offset of deferred tax assets against deferred tax liabilities.

(20 marks)

DipIFR 13 Dec Questions

4 Omega is a listed company which prepares financial statements in accordance with International Financial Reporting Standards (IFRS).

(a) On 1 October 2012, Omega purchased some land for $10 million (including legal costs of $1 million) in order to construct a new factory. Construction work commenced on 1 November 2012. Omega incurred the following costs in connection with its construction:

– Preparation and levelling of the land – $300,000.
– Purchase of materials for the construction – $6·08 million in total.
– Employment costs of the construction workers – $200,000 **per month**.
– Overhead costs incurred directly on the construction of the factory – $100,000 **per month**.
– Ongoing overhead costs allocated to the construction project using Omega's normal overhead allocation model – $50,000 **per month**.
– Income received during the temporary use of the factory premises as a car park during the construction period – $50,000.
– Costs of relocating employees to work at the new factory – $300,000.
– Costs of the opening ceremony on 31 July 2013 – $150,000.

The factory was completed on 31 May 2013 and production began on 1 August 2013. The overall useful life of the factory building was estimated at 40 years from the date of completion. However, it is estimated that the roof will need to be replaced 20 years after the date of completion and that the cost of replacing the roof at current prices would be 30% of the total cost of the building. At the end of the 40-year period Omega has a legally enforceable obligation to demolish the factory and restore the site to its original condition. The directors estimate that the cost of demolition in 40 years' time (based on prices prevailing at that time) will be $20 million. An annual risk adjusted discount rate which is appropriate to this project is 8%. The present value of $1 payable in 40 years' time at an annual discount rate of 8% is 4·6 cents.

The construction of the factory was partly financed by a loan of $17·5 million taken out on 1 October 2012. The loan was at an annual rate of interest of 6%. During the period 1 October 2012 to 28 February 2013 (when the loan proceeds had been fully utilised to finance the construction), Omega received investment income of $100,000 on the temporary investment of the proceeds.

Required:

Compute the carrying amount of the factory in the statement of financial position of Omega at 30 September 2013. You should explain your treatment of all the amounts referred to in this part in your answer.
(14 marks)

(b) On 1 October 2011 Omega granted share options to 200 senior executives. The options will vest on 30 September 2014 subject to the following conditions:

– Each executive will be entitled to 1,000 options if the cumulative profit in the three-year period from 1 October 2011 to 30 September 2014 exceeds $30 million. If the cumulative profit for this period is between $35 million and $40 million, then 1,500 options will vest. If the cumulative profit for the period exceeds $40 million, then 2,000 options will vest.
– If an executive leaves during the three-year vesting period, then that executive would forfeit any rights to share options.
– Notwithstanding the above, no options will vest unless the share price at 30 September 2014 exceeds $5.

Details of the fair values of the shares and share options at relevant dates are as follows:

Date	Fair value of An Omega share	Fair value of One of the options
	$	$
1 October 2011	4.00	0.50
30 September 2012	4.40	0.60
30 September 2013	4.60	0.75

DipIFR 13 Dec Questions

The estimate of the cumulative profit for the three-year period ending 30 September 2014 was revised each year as follows:

Date	Expected profit for the three-year period
	$m
1 October 2011	32
30 September 2012	39
30 September 2013	45

On 1 October 2011, none of the relevant executives were expected to leave in the three-year period from 1 October 2011 to 30 September 2014 and none left in the year ended 30 September 2012. However, 10 executives left unexpectedly on 30 June 2013. None of the other executives are expected to leave before 30 September 2014.

Omega correctly reflected this arrangement in its financial statements for the year ended 30 September 2012.

Required:

Prepare relevant extracts from the statement of financial position of Omega at 30 September 2013 and its statement of profit or loss and other comprehensive income for the year ended 30 September 2013. You should give appropriate explanations to support your extracts. (6 marks)

(20 marks)

End of Question Paper

DipIFR 13 Dec Questions

Diploma in International Financial Reporting

Tuesday 11 June 2013

Time allowed
Reading and planning: 15 minutes
Writing: 3 hours

ALL FOUR questions are compulsory and MUST be attempted.

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ALL FOUR questions are compulsory and MUST be attempted

1 Alpha holds investments in two other entities, Beta and Gamma. The statements of financial position of the three entities at 31 March 2013 were as follows:

	Alpha	Beta	Gamma
	$'000	$'000	$'000
ASSETS			
Non-current assets:			
Property, plant and equipment (Note 1)	280,000	225,000	200,000
Investments (Notes 1, 2 and 3)	78,500	40,000	10,000
	358,500	265,000	210,000
Current assets:			
Inventories (Note 4)	85,000	56,000	42,000
Trade receivables (Note 5)	70,000	42,000	38,000
Cash and cash equivalents	14,000	11,000	9,000
	169,000	109,000	89,000
Total assets	527,500	374,000	299,000
EQUITY AND LIABILITIES			
Equity			
Share capital ($1 shares)	160,000	120,000	100,000
Retained earnings	211,396	115,000	76,000
Other components of equity (Notes 2, 3 and 6)	5,604	4,000	2,000
Total equity	377,000	239,000	178,000
Non-current liabilities:			
Provision (Note 7)	1,500	Nil	Nil
Long-term borrowings (Note 8)	60,000	50,000	60,000
Deferred tax	22,000	25,000	17,000
Total non-current liabilities	83,500	75,000	77,000
Current liabilities:			
Trade and other payables (Note 5)	45,000	40,000	34,000
Short-term borrowings	22,000	20,000	10,000
Total current liabilities	67,000	60,000	44,000
Total equity and liabilities	527,500	374,000	299,000

Note 1 – Alpha's investment in Beta

On 1 April 2012, Alpha acquired 90 million shares in Beta by means of a share exchange. The terms of the business combination were as follows:

– Alpha issued eight shares for every nine shares acquired in Beta. On 1 April 2012, the market value of an Alpha share was $2·80.

– Alpha will make a further cash payment to the former shareholders of Beta on 30 June 2015. This payment will be based on the adjusted profits of Beta for the three-year period to 31 March 2015. On 1 April 2012, the fair value of this additional payment was estimated at $25 million. This estimate had increased to $28 million by 31 March 2013 due to changes in circumstances since the date of acquisition.

– Neither component of the investment in Beta has been recorded in the draft financial statements of Alpha presented above.

It is the group policy to value the non-controlling interest in subsidiaries at the date of acquisition at fair value. The market value of an equity share in Beta at 1 April 2012 can be used for this purpose. On 1 April 2012, the market value of a Beta share was $2·60.

On 1 April 2012, the individual financial statements of Beta showed the following reserves balances:

– Retained earnings $86 million.
– Other components of equity $2·4 million.

The directors of Alpha carried out a fair value exercise to measure the identifiable assets and liabilities of Beta at 1 April 2012. The following matters emerged:

– Property having a carrying value of $140 million (depreciable component $80 million) had an estimated market value of $160 million (depreciable component $92 million). The estimated future economic life of the depreciable component at 1 April 2012 was 16 years and this estimate remains valid.

– Plant and equipment having a carrying value of $111 million had an estimated market value of $120 million. The estimated future economic life of the plant and equipment at 1 April 2012 was three years and this estimate remains valid. Beta has not disposed of any of this plant and equipment since 1 April 2012.

– Intangible assets with an estimated market value of $8 million had not been recognised in the individual financial statements of Beta. The estimated future economic lives of these intangible assets at 1 April 2012 was four 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%.

No impairment of the goodwill on acquisition of Beta has occurred since 1 April 2012.

Note 2 – Alpha's investment in Gamma

On 1 April 2012, Alpha acquired 40 million shares in Gamma for a cash payment of $1·85 per share and debited $74 million to investments in its own statement of financial position. This enabled Alpha to exercise significant influence over Gamma but not to control Gamma. In its own financial statements, Alpha treated the investment in Gamma as a financial asset and made an election to measure it at fair value through other comprehensive income.

On 1 April 2012, the individual financial statements of Gamma showed the following reserves balances:

– Retained earnings $66 million.
– Other components of equity $1·2 million.

On 1 April 2012, there were no material differences between the carrying values of the net assets of Gamma in the individual financial statements and the fair values of those net assets.

On 31 March 2013, the fair value of Alpha's investment in Gamma was estimated at $78·5 million and this is the balance recorded in Alpha's individual financial statements. On 31 March 2013, Alpha credited $4·5 million to other components of equity. No deferred tax was recognised when making this entry.

In the consolidated financial statements you can ignore deferred tax when measuring the investment in Gamma.

Note 3 – Investments by Beta and Gamma

These investments are financial assets that are measured at fair value through other comprehensive income and have been correctly treated by Beta and Gamma. The other components of equity of Beta and Gamma relate entirely to these investments.

Note 4 – Inter-company sale of inventories

The inventories of Beta and Gamma at 31 March 2013 included components produced by Alpha. The selling price of the components included in the inventories of Beta was $14 million. The selling price of the components included in the inventories of Gamma was $12 million. Alpha applied a mark-up of one-third of its production cost in arriving at the sales price of these components. You can ignore deferred tax when making any adjustments due to the information in this note.

DipIFR 13 June Questions

Note 5 – Trade receivables and payables

The trade receivables of Alpha included $9 million receivable from Beta and $7·5 million receivable from Gamma in respect of the purchase of components (see Note 4). The trade payables of Beta and Gamma included equivalent amounts payable to Alpha.

Note 6 – Share based payment

On 1 April 2011, Alpha granted share options to senior executives that are due to vest on 31 March 2014. The maximum number of options that can vest is 10 million. However, there are vesting conditions that are service conditions. Each option allows the holder to purchase a share in Alpha for $2·50. Further details are as follows:

Date	Share price	Fair value of an option	Number of options expected to vest on 31 March 2014
1 April 2011	$2·50	36 cents	9 million
31 March 2012	$2·80	55 cents	9·2 million
31 March 2013	$3·00	90 cents	9·3 million

On 31 March 2012, the directors of Alpha correctly credited other components of equity and debited profit or loss with $1,104,000 in respect of these share options. No entries have been made in the financial statements since then in respect of the options.

Ignore any deferred tax implications of the granting of these share options.

Note 7 – Provision

On 1 October 2011, Alpha entered into a 10-year lease of office premises at an annual rental of $20 million. This lease was correctly classified as an operating lease and the rentals appropriately charged to profit or loss.

On 1 October 2011, Alpha began carrying out alterations to the premises. These alterations were completed on 31 March 2012 at a total cost of $18 million. Alpha included $18 million in its property, plant and equipment at 31 March 2012 and charged depreciation in the current year based on a 9½ year useful economic life.

The terms of the lease require Alpha to vacate the premises on 30 September 2021 and leave them in the same condition as they were on 1 October 2011. The directors estimate that this will require restoration expenditure of $14,250,000 on 30 September 2021. Accordingly, the directors recognised a provision of $1,500,000 ($14,250,000/9·5) at 31 March 2013. The directors debited $1,500,000 to profit or loss when recognising this provision.

A relevant discount rate to use in any discounting calculations is 8% per annum. The present value of $1 payable in 9½ years at this discount rate is 48 cents.

Note 8 – Long-term borrowings

The long-term borrowings of Alpha include $20 million that was received from a consortium of banks on 1 April 2012. The loan does not carry any interest but $30·6 million is repayable on 31 March 2017. Alpha incurred incremental costs of $1 million in arranging the loan which were charged to profit or loss in the year ended 31 March 2013. The effective annual rate of interest applicable to this loan is 10%.

Required:

Prepare the consolidated statement of financial position of Alpha at 31 March 2013.

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 \$. During the year ended 31 March 2013 the following events occurred:

(a) On 1 April 2012, Delta raised loan finance from European investors. The investors subscribed for 50 million €1 loan notes at par. Delta incurred incremental issue costs of €1 million. Interest of €4 million is payable annually on 31 March, starting on 31 March 2013. The loan is repayable in € on 31 March 2022 at a premium and the effective annual interest rate implicit in the loan is 10%. The appropriate measurement basis for this loan is amortised cost. Relevant exchange rates are as follows:

- 1 April 2012 – €1 = \$1·40.
- 31 March 2013 – €1 = \$1·45.
- Average for year ended 31 March 2013 – €1 = \$1·42. (7 marks)

(b) On 1 April 2012, Delta began joint construction of a pipeline with another investor. Delta and the other investor have signed a contract that provides for joint operation and ownership of the pipeline. All of the ongoing expenditure, comprising maintenance plus borrowing costs, was to be shared equally. The pipeline was completed on 1 October 2012. It was first used on 1 January 2013, at which date its estimated useful economic life was 20 years. The total cash cost of constructing the pipeline was \$40 million. This cost was partly financed by a loan of \$10 million taken out on 1 April 2012. The loan carries interest at an annual rate of 10% with interest payable in arrears on 31 March each year. Between 1 January 2013 and 31 March 2013, it was necessary to spend \$400,000 on maintenance costs. (7 marks)

(c) On 1 April 2012, the directors of Delta formed a new company, Epsilon. The directors of Delta own all the voting shares in Epsilon. In exercising their votes, the directors of Delta have agreed to act in Delta's best interests. Epsilon leased an asset from a financial institution and correctly classified this lease as a finance lease. Epsilon immediately leased the asset to Delta on a one year lease. The rentals payable by Delta to Epsilon were set at the same amount as the rentals payable by Epsilon to the financial institution. The terms of the lease from Epsilon to Delta gave Delta the option to extend the lease under exactly the same terms. This extension option will continue to be available on an annual basis until the lease between Epsilon and the financial institution expires. The asset is a vital one in Delta's production process. Epsilon does not undertake any other transactions. (6 marks)

Required:

Explain and show (where possible by quantifying amounts) how the three events would be reported in the financial statements of Delta for the year ended 31 March 2013.

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

(20 marks)

DipIFR 13 June Questions

3 **(a)** Revenue is often the largest single amount in the financial statements of a company and therefore it is very important to establish appropriate criteria for its recognition and measurement. IAS 18 – *Revenue* – was issued to establish such criteria.

Required:

(i) State the meaning of the term 'revenue' as it is used in IAS 18 and describe the requirements of IAS 18 for the measurement of revenue;

(ii) Summarise the criteria that need to be satisfied before revenue from the sale of goods can be recognised and identify any additional criteria that need to be satisfied in order to recognise revenue from the rendering of services.

Note: The total marks will be split equally between each part. (6 marks)

(b) Kappa prepares financial statements to 31 March each year. During the year ended 31 March 2013, Kappa entered into the following transactions:

(i) On 1 January 2013, Kappa supplied goods on credit to a customer. The goods had a list price of $450,000. Due to the size of the order, the customer received a volume discount of $50,000 and the invoice to the customer showed an amount payable of $400,000. The terms of sale allowed the customer a prompt payment discount of $20,000 provided payment was made before 31 January 2013. On 30 January 2013, the customer paid $380,000 in full and final settlement of the amount payable. (2 marks)

(ii) On 31 March 2013, Kappa supplied two machines to a customer. Both machines were accepted by the customer on 31 March 2013. Machine 1 was a machine that was routinely supplied by Kappa to many customers and the installation process was very simple. Machine 1 was installed on 2 April 2013 by employees of the customer. Machine 2 was more specialised and the installation process more complicated, requiring significant assistance from Kappa. Machine 2 was installed between 2 and 5 April 2013. Details of costs and sales prices are as follows:

	Machine 1	Machine 2	
	$'000	$'000	
Sales price	320	300	
Cost of production	160	150	
Cost of installation (to Kappa)	Nil	10	(4 marks)

(iii) On 30 September 2012, Kappa sold a property to a bank for $2 million. The carrying amount of the property at the date of sale was $1·5 million and its market value was $3·5 million. Property prices are expected to rise at an annual rate of 5% for the foreseeable future. Kappa continued to occupy this property but paid no rent to the new owners. Kappa has the option to repurchase the property on 30 September 2017 for $3·221 million. Kappa's credit rating is such that financial institutions would require an annual interest rate of 10% on loan finance to Kappa. (4 marks)

(iv) On 30 September 2012, Kappa delivered a machine to a customer that had been manufactured to that customer's requirements. The machine cost Kappa $600,000 to manufacture and the agreed selling price was $1,007,557. Kappa agreed to accept payment on 30 September 2015. Kappa would expect an annual rate of return of 8% on loan investments. The present value of $1 receivable in three years' time at an annual discount rate of 8% is approximately 79·4 cents. (4 marks)

Required:

Explain and show how the four transactions would be reported in the financial statements of Kappa for the year ended 31 March 2013 and (for transaction (ii) ONLY) the year ended 31 March 2014.

Note: The mark allocation is shown against each of the four transactions above.

(20 marks)

4 You are the financial controller of Omega, a listed company which prepares consolidated financial statements in accordance with International Financial Reporting Standards (IFRS). Your managing director, who is not an accountant, has recently attended a seminar and has prepared a number of questions for you concerning two issues raised at the seminar:

(a) 'I was confused regarding a number of references to fair value and a new accounting standard on the subject. I thought financial statements were prepared on a historical cost basis. Please give me three examples of where fair value might be relevant for us. I was told the new standard removed an inconsistency in the definition of fair value and applied three levels of input into the measurement of fair value. Please explain how the new standard defines fair value and what the previous inconsistency was. Please also explain each level of input and how each level is applied in measuring the fair value of a particular item in the financial statements.' (10 marks)

(b) 'One of the topics discussed at the seminar was segment reporting. I believe I heard someone say that segment reporting varies from company to company depending on its internal structure. Please explain how we should identify the segments we use to provide our segment reporting information. I do not need to know the detailed content of a segment report.' (10 marks)

Required:

Provide answers to the questions raised by the managing director.

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

(20 marks)

End of Question Paper

DipIFR 13 June Questions

Diploma in International Financial Reporting

Tuesday 9 December 2014

Time allowed
Reading and planning: 15 minutes
Writing: 3 hours

ALL FOUR questions are compulsory and MUST be attempted.

Do NOT open this paper until instructed by the supervisor.

During reading and planning time only the question paper may be annotated. You must NOT write in your answer booklet until instructed by the supervisor.

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

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ALL FOUR questions are compulsory and MUST be attempted

1 Alpha holds investments in two other entities, 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 30 September 2014 were as follows:

Statements of profit or loss and other comprehensive income

	Alpha $'000	Beta $'000	Gamma $'000
Revenue (Note 3)	260,000	200,000	180,000
Cost of sales (Notes 1-3)	(130,000)	(110,000)	(90,000)
Gross profit	130,000	90,000	90,000
Distribution costs	(20,000)	(15,000)	(13,500)
Administrative expenses (Note 4)	(25,000)	(20,000)	(18,000)
Redundancy and reorganisation costs (Note 5)	(14,000)	Nil	Nil
Investment income (Note 6)	12,600	Nil	1,500
Finance costs (Note 7)	(26,000)	(15,000)	(12,000)
Profit before tax	57,600	40,000	48,000
Income tax expense	(14,000)	(10,000)	(12,000)
Profit for the year	43,600	30,000	36,000
Other comprehensive income:			
Items that will not be reclassified to profit or loss			
Gains on financial assets designated at fair value through other comprehensive income (Note 8)	9,000	Nil	1,400
Total comprehensive income	52,600	30,000	37,400

Summarised statements of changes in equity

	Alpha	Beta	Gamma
Balance on 1 October 2013	180,000	140,000	120,000
Comprehensive income for the year	52,600	30,000	37,400
Dividends paid on 31 December 2013	(30,000)	(10,000)	(14,000)
Balance on 30 September 2014	202,600	160,000	143,400

Note 1 – Alpha's investment in Beta

On 1 October 2001, Alpha acquired 75% of the equity shares of Beta. This gave Alpha control over Beta. On 1 October 2001, the net assets of Beta had a fair value of $80 million. None of the assets and liabilities of Beta which existed on 1 October 2001 were still assets or liabilities of Beta on 30 September 2013. On 1 October 2001, Alpha measured the non-controlling interest in Beta at its fair value of $22 million. Goodwill on consolidation of $18 million arose on the acquisition of Beta. No impairment of goodwill on the acquisition of Beta has been necessary up to and including 30 September 2013.

Beta has four operating segments which are also cash generating units (CGUs) for the purposes of impairment reviews. On 1 October 2001, the goodwill on acquisition of Beta was allocated between these units on the following basis:

Unit 1 – $8 million.
Unit 2 – $4 million.
Unit 3 – $3 million.
Unit 4 – $3 million.

DipIFR 14 Dec Questions

On 30 September 2014, the carrying amounts of the net assets (excluding goodwill) and recoverable amounts of the four CGUs of Beta were as follows:

	Unit 1	Unit 2	Unit 3	Unit 4	Total
	$'000	$'000	$'000	$'000	$'000
Carrying amount	45,000	55,000	30,000	30,000	160,000
Recoverable amount	50,000	65,000	35,000	35,000	185,000

Any impairment of goodwill should be charged to cost of sales.

Note 2 – Alpha's investment in Gamma

On 1 February 2014, Alpha acquired 80% of the equity shares in Gamma and gained control of Gamma.

On 1 February 2014, the fair value of Gamma's property, plant and equipment exceeded the carrying amounts in the individual financial statements of Gamma as follows:

– Property **excess** $20 million (land element of excess $11 million). The estimated remaining useful life of the buildings element of the property at 1 February 2014 was 25 years.

– Plant and equipment **excess** $7·2 million. The estimated remaining useful life of the plant and equipment of Gamma at 1 February 2014 was three years.

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

Alpha measured the non-controlling interest in Gamma on 1 February 2014 at its fair value of $28 million. There was no impairment of the goodwill arising on the acquisition of Gamma in the year ended 30 September 2014. The profit of Gamma for the year ended 30 September 2014 accrued evenly over the year, but see note 8 regarding the other comprehensive income of Gamma.

Note 3 – Intra-group trading

Alpha supplies a component used by both Beta and Gamma. Alpha applies a mark-up of 25% to cost when computing the intra-group selling price. All of the sales of this component by Alpha to Gamma occurred after the acquisition of Gamma on 1 February 2014. Details of the sales of the component, and the holdings of inventory of the component by group entities, are as follows:

	Beta	Gamma
	$'000	$'000
Sales of the component	12,000	5,000
Inventory of component at 30 September 2014 (at cost to Beta/Gamma)	2,400	2,000
Inventory of component at 30 September 2013 (at cost to Beta/Gamma)	1,800	Nil

Note 4 – Post-employment benefits

The group makes contributions into both defined benefit and defined contribution retirement benefit plans. All the employees of Beta and Gamma are members of defined contribution plans but many of the employees of Alpha are members of a defined benefit plan. The following are relevant details regarding the defined benefit plan:

– Obligation at 30 September 2014: $40 million (30 September 2013: $32 million).
– Fair value of plan assets at 30 September 2014: $34 million (30 September 2013: $27 million).
– Current service cost for the year ended 30 September 2014: $6 million.
– Contributions paid into the plan by Alpha in the year ended 30 September 2014: $5·4 million.
– Benefits paid to retired members: $2 million.
– Relevant market yield: 5% per annum throughout the period.

Alpha has charged the contributions paid into the defined benefit plan in the year ended 30 September 2014 ($5·4 million) as an administrative expense. Alpha has made no other entries in respect of the plan in the statement of profit or loss and other comprehensive income. However, Alpha correctly accounted for the defined benefit plan in the financial statements for the year ended 30 September 2013.

DipIFR 14 Dec Questions

Note 5 – Redundancy and reorganisation costs

Following the acquisition of Gamma on 1 February 2014, the directors of Alpha formulated a plan to reorganise the group. The plan involved some redundancies and some employees changing their roles within the group. As a result of the reorganisation, certain non-current assets of Alpha will no longer be required. The final version of the plan was agreed on 31 July 2014 and made public on 15 August 2014. The plan was implemented from 1 November 2014. The total cost of the plan will be borne by Alpha. The directors of Alpha made a provision, with a corresponding charge to profit or loss, in respect of the plan as follows:

	$'000
Redundancy costs	10,000
Costs of training staff in new roles	5,500
Expected profit on the sale of surplus non-current assets	(1,500)
	14,000

Note 6 – Investment income

All of the investment income of Alpha, including dividends received from subsidiaries, has been correctly recognised in the individual financial statements of Alpha.

Note 7 – Bond issue

On 1 October 2013, Alpha issued 300 million $1 bonds at par. The interest payable on the bonds is 5% per annum, payable on 30 September in arrears. The bonds are repayable at par on 30 September 2023. Alternatively, the investors have the option to convert the bonds into equity shares in Alpha on 30 September 2023.

On 1 October 2013, Alpha recognised a financial liability of $300 million in its statement of financial position. On 30 September 2014, Alpha recognised the interest paid on that date as a finance cost in its statement of profit or loss.

On 1 October 2013, investors would have expected an annual return of 8% on non-convertible bonds. At a discount rate of 8% per annum, the present value of $1 receivable at the end of year 10 is 46·3 cents and the present value of $1 receivable at the end of each of years 1 to 10 is $6·71.

Note 8 – Other comprehensive income

Both Alpha and Gamma have financial assets which are appropriately classified as fair value through other comprehensive income. On 1 February 2014, the fair value of the financial assets of Gamma had not changed from 30 September 2013.

Note 9 – Forward currency contract

On 15 August 2014, Alpha entered into a commitment to supply a large consignment of components to a foreign customer whose currency is the Kroner. The agreed value of the order was 25 million Kroner and this amount is expected to be paid by the customer on 30 November 2014. On 15 August 2014, Alpha entered into a contract to sell 25 million Kroner for $13 million on 30 November 2014. Currency fluctuations in August and September 2014 were such that on 30 September 2014 the fair value of this currency contract was $1·1 million (a financial liability). The draft financial statements of Alpha do not include any amounts in respect of this currency contract since it has a zero cost. Alpha wishes to use cash-flow hedge accounting whenever permitted by International Financial Reporting Standards. The directors of Alpha have estimated that the currency contract is a perfectly effective hedge of the commitment to supply the components.

DipIFR 14 Dec Questions

Required:

(a) Prepare the consolidated statement of profit or loss and other comprehensive income of Alpha for the year ended at 30 September 2014. You do not need to consider the deferred tax effects of any adjustments you make. (32 marks)

(b) Prepare the summarised consolidated statement of changes in equity of Alpha for the year ended 30 September 2014, including a column for the non-controlling interest. (8 marks)

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

(40 marks)

DipIFR 14 Dec Questions

2 Delta is an entity which prepares financial statements to 30 September each year. Each year the financial statements are authorised for issue on 30 November. During the year ended 30 September 2014, the following transactions occurred:

(a) On 1 October 2013, Delta sold a machine to a customer for a total price of $500,000. Delta invoiced the customer for $500,000 on 1 October 2013 and the customer made a payment of $500,000 to Delta on 15 October 2013. The terms of sale included an arrangement that Delta would service and maintain the machine for a four-year period from 1 October 2013. Delta would normally charge an annual fee of $37,500 for a service and maintenance arrangement of this nature.

The normal selling price of the machine without a service and maintenance arrangement was $450,000. The saving available to the customer as a result of purchasing the machine and the service and maintenance arrangement should be allocated to the two components of the transaction in proportion to their stand-alone fair values. (9 marks)

(b) On 1 October 2013, Delta completed the construction of a factory at a total construction cost of $40 million. The factory was constructed on land which was being leased on an operating lease until 30 September 2053. Annual lease rentals were $800,000, payable on 30 September in arrears. The expected useful economic life of the factory at 1 October 2013 was 40 years. Under the terms of the leasing agreement, Delta is required to dismantle the factory on 30 September 2053 and return the land to its original state. The latest estimated cost of this process, **at 30 September 2053 prices**, is $55 million. An appropriate discount rate to use in any relevant calculations is 5% per annum. At this discount rate, the present value of $1 receivable in 40 years is 14·2 cents. (8 marks)

(c) On 15 May 2014, Delta was notified that a customer (Chi) was taking legal action against Delta in respect of financial losses incurred by Chi. Chi alleged that the financial losses were caused due to the supply by Delta of faulty products on 30 November 2013. Delta defended the case but considered, based on the progress of the case up to 30 September 2014, that there was a 75% probability they would have to pay damages of $20 million to the customer. The case was ultimately settled by Delta paying damages of $18 million to Chi on 15 November 2014. (3 marks)

Required:

Explain and show (where possible by quantifying amounts) how the three events would be accounted for in the financial statements of Delta for the year ended 30 September 2014.

Note: The mark allocation is shown against each of the three events above. You should assume that all transactions described here are material.

(20 marks)

3 (a) IFRS 3 – *Business Combinations* – prescribes the method of accounting to be used when an entity (the acquirer) obtains control of a business. Control is not defined in IFRS 3 but a definition is provided in IFRS 10 – *Consolidated Financial Statements*.

Required:

(i) Define 'control' as outlined in IFRS 10. Where relevant, you should provide appropriate explanations for the terms you use in your definition. (4 marks)

(ii) Explain the way in which goodwill on acquisition and gains on bargain purchases should be initially computed and subsequently accounted for. (5 marks)

(b) Epsilon prepares consolidated financial statements to 30 September each year. On 1 January 2014, Epsilon acquired 75% of the equity shares of Kappa and gained control of Kappa. Kappa has 12 million equity shares in issue. Details of the purchase consideration are as follows:

– On 1 January 2014, Epsilon issued two shares for every three shares acquired in Kappa. On 1 January 2014, the market value of an equity share in Epsilon was $6·50 and the market value of an equity share in Kappa was $6·00.

– On 31 December 2014, Epsilon will make a cash payment of $7·15 million to the former shareholders of Kappa who sold their shares to Epsilon on 1 January 2014. On 1 January 2014, Epsilon would have needed to pay interest at an annual rate of 10% on borrowings.

– On 31 December 2015, Epsilon may make a cash payment of $30 million to the former shareholders of Kappa who sold their shares to Epsilon on 1 January 2014. This payment is contingent upon the revenues of Epsilon growing by 15% over the two-year period from 1 January 2014 to 31 December 2015. On 1 January 2014, the fair value of this contingent consideration was $25 million. On 30 September 2014, the fair value of the contingent consideration was $22 million.

On 1 January 2014, the carrying values of the identifiable net assets of Kappa in the books of that company totalled $60 million. On 1 January 2014, the fair values of these net assets totalled $70 million. The rate of deferred tax to apply to temporary differences is 20%.

During the nine months ended on 30 September 2014, Kappa had a poorer than expected operating performance. Therefore on 30 September 2014 it was necessary for Epsilon to recognise an impairment of the goodwill arising on acquisition of Kappa, amounting to 10% of its total computed value.

Required:

Compute the impairment of goodwill and explain how this impairment should be recognised in the consolidated financial statements of Epsilon. You should do this under BOTH the methods permitted by IFRS 3 for the initial computation of the non-controlling interest in Kappa at the date of acquisition.

(11 marks)

(20 marks)

DipIFR 14 Dec Questions

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 managing director, who is not an accountant, has recently been appointed. She formerly worked for Rival, one of Omega's key competitors. She has reviewed the financial statements of Omega for the year ended 30 September 2014 and has prepared a series of queries relating to those statements:

Query One

'I was very confused by the note that included financial information relating to our operating segments. This note bears very little resemblance to the equivalent note included in the financial statements of Rival. Please explain how the two notes can be so different.' (8 marks)

Query Two

'The notes to our financial statements refer to equity settled share-based payments relating to the granting of share options. When I joined Omega, I was granted share options but I can only exercise those options if I achieve certain performance targets in my first three years as managing director. I know that other directors are also granted similar option arrangements. I don't see why they affect the financial statements when the options are granted though, because no cash is involved unless the options are exercised. Please explain to me exactly what is meant by an 'equity settled share-based payment'. Please also explain how, and when, equity settled share-based payments affect the financial statements of entities that grant them to their employees. I would like to know how such 'payments' are measured, over what period the 'payments' are recognised, and exactly what accounting entries are involved.' (8 marks)

Query Three

'I was confused when I looked at the statement of financial position and saw that the assets and liabilities were divided up into three sections and not two. The current and non-current sections I understand but I don't understand the 'non-current assets held for sale' and 'liabilities directly associated with non-current assets held for sale' sections. Please explain the meaning and accounting treatment of a non-current asset held for sale. Please also explain how there can be liabilities directly associated with non-current assets held for sale.' (4 marks)

Required:

Provide answers to the three queries raised by the managing director. 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

DipIFR 14 Dec Questions

Diploma in International Financial Reporting

Tuesday 10 June 2014

Time allowed
Reading and planning: 15 minutes
Writing: 3 hours

ALL FOUR questions are compulsory and MUST be attempted.

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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 two other entities, Beta and Gamma. The statements of profit or loss and other comprehensive income of the three entities for the year ended 31 March 2014 were as follows:

Statements of profit or loss and other comprehensive income

	Alpha	Beta	Gamma
	$'000	$'000	$'000
Revenue (note 4)	420,000	335,000	292,000
Cost of sales (note 4)	(240,000)	(192,000)	(168,000)
Gross profit	180,000	143,000	124,000
Distribution costs	(20,000)	(16,000)	(14,000)
Administrative expenses	(40,000)	(32,000)	(28,000)
Contributions to retirement benefit plan (note 5)	(5,000)	Nil	Nil
Finance costs	(20,000)	(15,000)	(12,000)
Investment income (note 6)	33,000	Nil	Nil
Profit before tax	128,000	80,000	70,000
Income tax expense	(32,000)	(20,000)	(16,000)
Profit for the year	96,000	60,000	54,000
Other comprehensive income:			
Items that will not be reclassified to profit or loss			
Gain on property revaluation (note 7)	25,000	Nil	12,000
Total comprehensive income for the year	121,000	60,000	66,000

Notes to the statements

Note 1 – Acquisition of Beta

On 1 April 2005, Alpha purchased 80% of the equity shares of Beta and gained control of Beta. Goodwill arising on the acquisition of Beta totalled $80 million. At 1 April 2005, Beta had three cash-generating units and the goodwill on acquisition was allocated to the three units as follows:

– Unit 1 – 40%
– Unit 2 – 35%
– Unit 3 – 25%.

No impairment of this goodwill had occurred in the years ended 31 March 2006 to 2013 inclusive. However, in the year ended 31 March 2014, despite Beta making a profit overall, Beta suffered challenging trading conditions. Therefore the directors of Alpha carried out an impairment review on the goodwill at 31 March 2014 and obtained the following results:

Unit	Carrying value of net assets (excluding goodwill) at 31 March 2014	Recoverable amount at 31 March 2014
	$'000	$'000
1	215,000	255,000
2	185,000	220,000
3	130,000	140,000
Total	530,000	615,000

None of the assets or liabilities of Beta which Alpha identified on 1 April 2005 remained in the statement of financial position of Beta at 31 March 2013 or 2014. Any impairment of goodwill should be charged to cost of sales.

Alpha measures all non-controlling interests based on their fair values at the date of acquisition of the relevant subsidiary.

DipIFR 14 June Questions

Note 2 – Acquisition of Gamma

On 1 July 2013, Alpha acquired 40% of the equity capital of Gamma. The purchase consideration comprised the following:

– An issue of equity shares.

– A cash payment of $65·34 million due on 30 June 2015. On 1 July 2013, Alpha's borrowing rate was 10% per annum. No entry has yet been made in Alpha's financial statements regarding this future cash payment.

The other 60% of Gamma's shares are held by a wide variety of investors, none of whom owns more than 0·5% individually. None of the other shareholders has any arrangements to consult any of the others or make collective decisions. Since 1 July 2013, Alpha has actively participated in establishing the operating and financial policies of Gamma.

When reviewing the net assets of Gamma as at 1 July 2013, the directors of Alpha ascertained the following:

– The properties of Gamma had been revalued at 31 March 2013 and there was no significant difference between their carrying values at 1 July 2013 and their fair values at 31 March 2013.

– The plant and equipment of Gamma had a carrying value at 1 July 2013 of $70 million and a fair value at that date of $78 million. The estimated future useful life of the property, plant and equipment at 1 July 2013 was four years, with zero residual value.

– On 1 July 2013, Gamma was in the process of completing the development of a new method of production which will significantly reduce wastage. As at 1 July 2013, Gamma had recognised an intangible asset of $10 million in its financial statements in respect of this development. The directors of Alpha believed that, as at 1 July 2013, the process had a fair value of $22 million and that the process will produce economic benefits evenly for ten years from 1 January 2014.

– On 1 July 2013, Gamma had a contingent liability which it did not recognise in its own financial statements. This contingent liability still existed, and was still unrecognised by Gamma, at 31 March 2014. As at 1 July 2013, the directors of Alpha believed that the contingent liability had a fair value of $16 million. On 31 March 2014, they reassessed its fair value at $12 million. The reassessment was due to a change in circumstances after 1 July 2013.

The directors of Alpha believe that the facts described in this note mean that Gamma has been a subsidiary of Alpha since 1 July 2013 and wish to consolidate it. Based on the assumption that Gamma is consolidated, no impairment of the goodwill on consolidation is required at 31 March 2014. The profit of Gamma for the year ended 31 March 2014 accrued evenly over the year. However, as noted above, all of the other comprehensive income of Gamma arose after 1 July 2013. Any consolidation adjustments which are necessary as a result of the information given in this note should be regarded as temporary differences for the purpose of computing deferred taxation. The rate of corporate income tax in the jurisdiction in which all three entities are located is 25%.

Note 3 – Presentation of depreciation and amortisation

All depreciation and amortisation charges should be presented as part of cost of sales

Note 4 – Trading between Alpha and Beta

1. Alpha supplies a component to Beta which is used by Beta in its production process. Alpha marks up its cost of production by one-third in arriving at the selling price. In the year ended 31 March 2014, the revenues of Alpha included $30 million in respect of the sale of these components. On 31 March 2014, the inventories of Beta included $6 million. On 31 March 2013, the inventories of Beta included $4·4 million in respect of identical unsold components purchased from Alpha at the same mark up on cost.

2. During the year ended 31 March 2013, Alpha manufactured a machine which was to be used by Beta from 1 April 2013. The costs of manufacture totalled $12 million. On 1 April 2013, Alpha transferred the machine to Beta for an invoiced price of $16 million, including relevant amounts in revenue and cost of sales. Beta included the machine in its property, plant and equipment and depreciated the machine over its estimated useful life of four years, with no residual value.

Any consolidation adjustments which are necessary as a result of the information given in this note should be regarded as temporary differences for the purpose of computing deferred taxation.

DipIFR 14 June Questions

Note 5 – Defined benefit retirement benefits plan

Certain senior executives of Alpha belong to a defined benefit retirement benefits plan. In the financial statements of Alpha, the contributions paid into this plan have been shown as an expense in the statement of profit or loss and other comprehensive income. Relevant information regarding this plan is as follows:

– The pension liability was $60m at 31 March 2013. This liability increased to $68m by 31 March 2014.
– The pension asset was $40m at 31 March 2013. This asset increased to $46m by 31 March 2014.
– The current service cost was $4·5m.
– Alpha's borrowing rate at 31 March 2014 was 9% per annum. On that date market yields on government bonds were 8% per annum.

The salary costs of the senior executives who belong to this plan are presented in administrative expenses. You should ignore any adjustment to deferred tax as a result of the information included in this note.

Note 6 – Payment of dividends

On 31 December 2013, Beta paid a dividend of $30 million and Gamma paid a dividend of $20 million. Alpha recognised its share of both dividends in its investment income.

Note 7 – Property revaluations

It is the policy of the Alpha group to measure freehold properties using the fair value model and all freehold properties were revalued on 31 March 2014. Beta leases all of its properties and all of Beta's property leases are operating leases. The gains shown in the financial statements of Alpha and Gamma do not take account of the deferred tax implications of the revaluations.

Note 8 – Hedge of future property purchase

On 1 February 2014, Alpha entered into a firm commitment to purchase a property on 31 May 2014 for €40 million. In order to eliminate the impact of currency fluctuations, on 1 February 2014 Alpha entered into a contract to purchase €40 million for $48 million on 31 May 2014. This contract had no cost and Alpha did not record it in the financial statements for the year ended 31 March 2014. On 31 March 2014, the contract had a fair value of $3·6 million (financial asset). Alpha uses hedge accounting whenever permitted by International Financial Reporting Standards. Where a choice of hedge accounting method exists, Alpha uses cash-flow hedge accounting.

You should ignore any adjustment to deferred tax as a result of the information included in this note.

Required:

(a) Discuss the appropriateness of the directors' view that Gamma became a subsidiary of Alpha on 1 July 2013. (5 marks)

(b) Prepare the consolidated statement of profit or loss and other comprehensive income of Alpha for the year ended 31 March 2014. For this part you should assume that Gamma is a subsidiary of Alpha from 1 July 2013. (35 marks)

(40 marks)

DipIFR 14 June Questions

2 Delta is an entity which prepares financial statements to 31 March each year. During the year ended 31 March 2014 the following events affected Delta:

(a) On 1 April 2012, Delta had granted share appreciation rights to 200 senior executives. Each executive will receive 2,000 rights on 31 March 2015 provided he or she continues to be employed by Delta at that date. On 1 April 2012, the directors estimated that all the executives would remain employed by Delta for the three-year period ending on 31 March 2015. However, 10 executives left in the year ended 31 March 2013 and at 31 March 2013 the directors believed that a further 10 executives would leave in the following two years. Five executives actually left in the year ended 31 March 2014 and the directors now believe that seven more directors will leave in the year ended 31 March 2015. Since 1 April 2012, the fair value of the share appreciation rights has fluctuated as follows:

Date	Fair value of one right
	$
1 April 2012	1·60
31 March 2013	1·80
31 March 2014	1·74

(8 marks)

(b) On 1 April 2013, Delta completed the manufacture of some inventory at a total cost of $800,000. In order to be suitable for sale in the ordinary course of business, the completed inventory needed to be stored in controlled conditions for a two-year period. The inventory is expected to sell for $1,200,000 after the two-year storage period. On 1 April 2013, Delta sold the inventory to Epsilon, a bank. The agreed sales proceeds were $810,000 but Epsilon charged Delta an administration fee of $10,000, so the net amount received by Delta was $800,000. Delta retained physical custody of the inventory and continued to ensure that it was stored in the appropriate conditions. Delta indemnified Epsilon against any losses caused by theft or inappropriate storage of the inventory. Delta has the option to repurchase the inventory on 31 March 2015 for $933,120. On 1 April 2013, Epsilon would have required an annual return of 8% on loans made to customers such as Delta.

(7 marks)

(c) On 1 April 2013, Delta leased a machine from Kappa on a three-year lease. The expected future economic life of the machine on 1 April 2013 was eight years. If the machine breaks down, then under the terms of the lease, Kappa would be required to repair the machine or provide a replacement. Kappa agreed to allow Delta to use the machine for the first six months of the lease without the payment of any rental as an incentive to Delta to sign the lease agreement. After this initial period, lease rentals of $210,000 were payable six-monthly in arrears, the first payment falling due on 31 March 2014. (5 marks)

Required:

Explain and illustrate (where possible by quantifying amounts) how the three events would be reported in the financial statements of Delta for the year ended 31 March 2014.

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

(20 marks)

3 (a) Deferred tax is the tax on temporary differences. Temporary differences are identified on individual assets and liabilities in the statement of financial position. Temporary differences arise when the carrying value of an asset or liability differs from its tax base.

Required:

Explain:

(i) How IAS 12 – *Income Taxes* – defines the tax base of assets and liabilities. (3 marks)

(ii) How temporary differences are identified as taxable or deductible temporary differences. (2 marks)

(iii) The general criteria prescribed by IAS 12 for the recognition of deferred tax assets and liabilities. You do NOT need to identify any specific exceptions to these general criteria. (2 marks)

(b) Epsilon prepares consolidated financial statements to 31 March each year. During the year ended 31 March 2014, the following events affected the tax position of the group:

(i) Lambda, a wholly owned subsidiary of Epsilon, made a loss adjusted for tax purposes of $3 million. Lambda is unable to utilise this loss against previous tax liabilities and local tax legislation does not allow Lambda to transfer the tax loss to other group companies. Local legislation does allow Lambda to carry the loss forward and utilise it against its own future taxable profits. The directors of Epsilon do not consider that Lambda will make taxable profits in the foreseeable future. (2 marks)

(ii) Just before 31 March 2014, Epsilon committed itself to closing a division after the year end, making a number of employees redundant. Therefore Epsilon recognised a provision for closure costs of $2 million in its statement of financial position as at 31 March 2014. Local tax legislation allows tax deductions for closure costs only when the closure actually takes place. In the year ended 31 March 2015, Epsilon expects to make taxable profits which are well in excess of $2 million. On 31 March 2014, Epsilon had taxable temporary differences from other sources which were greater than $2 million. (3 marks)

(iii) During the year ended 31 March 2014, Epsilon capitalised development costs which satisfied the criteria in paragraph 57 of IAS 38 – *Intangible Assets*. The total amount capitalised was $1·6 million. The development project began to generate economic benefits for Epsilon from 1 January 2014. The directors of Epsilon estimated that the project would generate economic benefits for five years from that date. The development expenditure was fully deductible against taxable profits for the year ended 31 March 2014. (3 marks)

(iv) On 1 April 2013, the total goodwill arising on consolidation in Epsilon's consolidated statement of financial position was $4 million. On 31 March 2014, the directors reviewed the goodwill for impairment and concluded that the goodwill was impaired by $600,000. There was no tax deduction available for any group company as a consequence of this impairment charge as at 31 March 2014. (2 marks)

(v) On 1 April 2013, Epsilon borrowed $10 million. The cost to Epsilon of arranging the borrowing was $200,000 and this cost qualified for a tax deduction on 1 April 2013. The loan was for a three-year period. No interest was payable on the loan but the amount repayable on 31 March 2016 will be $13,043,800. This equates to an effective annual interest rate of 10%. Under the tax jurisdiction in which Epsilon operates, a further tax deduction of $3,043,800 will be claimable when the loan is repaid on 31 March 2016. (3 marks)

Required:

Explain and show how each of these events would affect the deferred tax assets/liabilities in the consolidated statement of financial position of the Epsilon group at 31 March 2014. Where relevant, you should assume the rate of corporate income tax is 25%

Note: The mark allocation is shown against each of the five transactions above.

(20 marks)

DipIFR 14 June Questions

4 You are the financial controller of Omega, a listed company which prepares consolidated financial statements in accordance with International Financial Reporting Standards (IFRS). The year end of Omega is 31 March and its functional currency is the $. Your managing director, who is not an accountant, has recently prepared a list of questions for you concerning current issues relevant to Omega:

(a) One of my fellow directors has informed me that on 1 January 2014 his spouse acquired a controlling interest in one of our major suppliers, Sigma. He seemed to think that this would have implications for our financial statements. I cannot understand why. Our purchases from Sigma were $1·5 million for each month of our year ended 31 March 2014 and I acknowledge this is a significant amount for us. However, I can't see how the share purchase on 1 January 2014 affects **our** financial statements – all the purchases from Sigma were made at normal market rates, so what's the issue? Please explain this to me and identify any impact on our financial statements. (7 marks)

(b) You will be aware that we intend to open a new retail store in a new location in the next few weeks. As you know, we have spent a substantial sum on a series of television advertisements to promote this new store. We paid for advertisements costing $800,000 before 31 March 2014. $700,000 of this sum relates to advertisements shown before 31 March 2014 and $100,000 to advertisements shown in April 2014. Since 31 March 2014, we have paid for further advertisements costing $400,000. I was chatting to a colleague over lunch and she told me she thought **all** these costs should be written off as expenses in the year to 31 March 2014. I don't want a charge of $1·2 million against my 2014 profits! Surely these costs can be carried forward as intangible assets? After all, our market research indicates that this new store is likely to be highly successful. Please explain and justify the treatment of these costs of $1·2 million in the financial statements for the year ended 31 March 2014. (6 marks)

(c) As you know, on 1 January 2014 we purchased a machine for 2 million kroner. At that date the exchange rate was $1= 10 kroner. We don't have to pay for this purchase until 30 June 2014. The kroner strengthened against the $ in the three months following purchase and by 31 March 2014 the exchange rate was $1 = 8 kroner. I thought these exchange fluctuations wouldn't affect our financial statements because we have an asset and a liability denominated in kroner which was initially the same amount. We're depreciating this machine over four years so the future year-end amounts won't be the same, of course. Something I heard at a seminar, but didn't really grasp, made me think I could be mistaken. Please explain the impact of this transaction on our financial statements for the year ended 31 March 2014. (7 marks)

Required:

Provide answers to the issues raised by the managing director.

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

(20 marks)

End of Question Paper

DipIFR 14 June Questions

Diploma in International Financial Reporting

Friday 11 December 2015

Time allowed
Reading and planning: 15 minutes
Writing: 3 hours

ALL FOUR questions are compulsory and MUST be attempted.

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

During reading and planning time only the question paper may be annotated. You must NOT write in your answer booklet until instructed by the supervisor.

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

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The question paper begins on page 3.

DipIFR 15 Dec Questions

ALL FOUR questions are compulsory and MUST be attempted

1 Alpha's investments include two subsidiaries, Beta and Gamma. The draft statements of financial position of the three entities at 30 September 2015 were as follows:

	Alpha $'000	Beta $'000	Gamma $'000
Assets			
Non-current assets:			
Property, plant and equipment (Notes 1 and 3)	380,000	355,000	152,000
Intangible assets (Note 1)	80,000	40,000	20,000
Investments (Notes 1, 3 and 4)	497,000	Nil	Nil
	957,000	395,000	172,000
Current assets:			
Inventories (Note 5)	100,000	70,000	65,000
Trade receivables (Note 6)	80,000	66,000	50,000
Cash and cash equivalents (Note 6)	10,000	15,000	10,000
	190,000	151,000	125,000
Total assets	1,147,000	546,000	297,000
Equity and liabilities			
Equity			
Share capital (50c shares)	150,000	200,000	120,000
Retained earnings (Notes 1 and 3)	498,000	186,000	60,000
Other components of equity (Notes 1, 3 and 4)	295,000	10,000	2,000
Total equity	943,000	396,000	182,000
Non-current liabilities:			
Provision (Note 7)	34,000	Nil	Nil
Long-term borrowings (Note 8)	60,000	50,000	45,000
Deferred tax	35,000	30,000	25,000
Total non-current liabilities	129,000	80,000	70,000
Current liabilities:			
Trade and other payables (Note 6)	50,000	55,000	35,000
Short-term borrowings	25,000	15,000	10,000
Total current liabilities	75,000	70,000	45,000
Total equity and liabilities	1,147,000	546,000	297,000

Note 1 – Alpha's investment in Beta

On 1 October 2012, Alpha acquired 300 million shares in Beta by means of a share exchange of one share in Alpha for every two shares acquired in Beta. On 1 October 2012, the market value of an Alpha share was $2·40. Alpha incurred directly attributable costs of $2 million on acquisition of Beta. These costs comprised:

– $0·8 million – cost of issuing own shares, debited to Alpha's share premium account within other components of equity;

– $1·2 million due diligence costs – included in the carrying amount of the investment in Beta in Alpha's own statement of financial position.

There has been no change to the carrying amount of this investment in Alpha's own statement of financial position since 1 October 2012.

DipIFR 15 Dec Questions

On 1 October 2012, the individual financial statements of Beta showed the following reserves balances:

– Retained earnings $125 million.
– Other components of equity $10 million.

The directors of Alpha carried out a fair value exercise to measure the identifiable assets and liabilities of Beta at 1 October 2012. The following matters emerged:

– Plant and equipment having a carrying amount of $295 million had an estimated market value of $340 million. The estimated remaining useful economic life of this plant at 1 October 2012 was five years. None of this plant and equipment had been disposed of between 1 October 2012 and 30 September 2015.

– An in-process research and development project existed at 1 October 2012 but did not meet the recognition criteria of IAS 38 – *Intangible Assets*. The fair value of the research and development project at 1 October 2012 was $20 million. The project started to generate economic benefits on 1 October 2013 over an estimated period of four years.

The above two fair value adjustments have not been reflected in the individual financial statements of Beta. In the consolidated financial statements, these 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%.

Alpha uses the proportion of net assets method to calculate non-controlling interests in Beta.

Note 2 – Impairment review of goodwill on acquisition of Beta

No impairment of the goodwill on acquisition of Beta was evident when reviews were carried out on 30 September 2013 and 2014. On 30 September 2015, the directors of Alpha concluded that the recoverable amount of the net assets (including the goodwill) of Beta at that date was $450 million. Beta is regarded as a single cash generating unit for the purpose of measuring goodwill impairment.

Note 3 – Alpha's investment in Gamma

On 1 October 2014, Alpha acquired 144 million shares in Gamma by means of a cash payment of $125 million. Alpha incurred costs of $1 million associated with this purchase and debited these costs to administrative expenses in its draft statement of profit or loss for the year ended 30 September 2015. There has been no change in the carrying amount of this investment in the financial statements of Alpha since 1 October 2014.

On 1 October 2014, the individual financial statements of Gamma showed the following reserves balances:

– Retained earnings $45 million.
– Other components of equity $2 million.

On 1 October 2014, the fair values of the net assets of Gamma were the same as their carrying amounts with the exception of some land which had a carrying amount of $100 million and a fair value of $130 million. This land continued to be an asset of Gamma at 30 September 2015. The fair value adjustment has not been reflected in the individual financial statements of Gamma. In the consolidated financial statements, the fair value adjustment 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%.

There was no impairment of the goodwill arising on acquisition of Gamma in the consolidated financial statements at 30 September 2015.

Alpha uses the proportion of net assets method to calculate non-controlling interests in Gamma.

Note 4 – Other investments

Apart from its investments in Beta and Gamma, the investments of Alpha included in the statement of financial position at 30 September 2015 are all financial assets which Alpha measures at fair value though other comprehensive income. These other investments are correctly measured in accordance with IFRS 9 – *Financial Instruments*.

Note 5 – Intra-group sale of inventories

The inventories of Alpha and Gamma at 30 September 2015 included components purchased from Beta in the last three months of the financial year at a cost of $20 million to Alpha and $16 million to Gamma. Beta supplied these goods to both Alpha and Gamma at a mark-up of 25% on the cost to Beta.

Note 6 – Trade receivables and payables

Group policy is to clear intra-group balances on a given date prior to each year end. All group companies had complied with this policy at 30 September 2015, so at that date there were no outstanding intra-group balances.

Note 7 – Provision

On 30 September 2015, Alpha finalised the construction of an energy generating facility. The facility has an expected useful economic life of 25 years and Alpha has a legal requirement to decommission the facility at the end of its estimated useful life. The directors of Alpha estimated the costs of this decommissioning to be $34 million – based on prices prevailing at 30 September 2040. At an appropriate discount rate the present value of the cost of decommissioning the facility is $10 million. The directors of Alpha made a provision of $34 million and charged this amount as an operating cost in the financial statements of Alpha for the year ended 30 September 2015.

Note 8 – Long-term borrowings

On 1 October 2014, Alpha issued 40 million $1 bonds at par. The cost of issuing the bonds was $1 million and this cost was charged as a finance cost for the year ended 30 September 2015. No interest is payable on the bonds but they are redeemable at a large premium which makes their effective finance cost 8% per annum. The bonds are included at a carrying amount of $40 million in the statement of financial position of Alpha at 30 September 2015.

Required:

(a) **Prepare the consolidated statement of financial position of Alpha at 30 September 2015. You need only consider the deferred tax implications of any adjustments you make where the question specifically refers to deferred tax.** (36 marks)

(b) On 15 November 2015, Alpha purchased shares in Theta which gave Alpha a 45% shareholding in Theta. On the same date, Alpha purchased an option which gave Alpha the right to acquire an additional 10% of the shares in Theta from the existing shareholders. This option is exercisable at any time between 15 November 2015 and 30 September 2017 at a price which makes it highly likely the option will be exercised during that period. The directors of Alpha are unsure how to treat Theta in the consolidated financial statements for the year ended 30 September 2016.

Required:

Advise the directors of Alpha on the appropriate treatment of Theta in the consolidated financial statements for the year ended 30 September 2016 PRIOR to any exercising of the option. (4 marks)

(40 marks)

DipIFR 15 Dec Questions

2 Delta is an entity which is engaged in the construction industry and prepares financial statements to 30 September each year. The financial statements for the year ended 30 September 2015 are shortly to be authorised for issue. The following events are relevant to these financial statements:

(a) On 1 October 2000, Delta purchased a large property for $20 million and immediately began to lease the property to Epsilon on an operating lease. Annual rentals were $2 million. On 30 September 2014, the fair value of the property was $26 million. Under the terms of the lease, Epsilon was able to cancel the lease by giving six months' notice in writing to Delta. Epsilon gave this notice on 30 September 2014 and vacated the property on 31 March 2015. On 31 March 2015, the fair value of the property was $29 million. On 1 April 2015, Delta immediately began to convert the property into ten separate flats of equal size which Delta intended to sell in the ordinary course of its business. Delta spent a total of $6 million on this conversion project between 31 March 2015 and 30 September 2015. The project was incomplete at 30 September 2015 and the directors of Delta estimate that they need to spend a further $4 million to complete the project, after which each flat could be sold for $5 million. Delta uses the fair value model to measure property whenever permitted by International Financial Reporting Standards. (9 marks)

(b) On 1 August 2015, Delta purchased a machine from a supplier located in a country whose local currency is the groat. The agreed purchase price was 600,000 groats, payable on 31 October 2015. The asset was modified to suit Delta's purposes at a cost of $30,000 during August 2015 and brought into use on 1 September 2015. The directors of Delta estimated that the useful economic life of the machine from date of first use was five years. Relevant exchange rates were as follows:

- 1 August 2015 – 2·5 groats to $1.
- 1 September 2015 – 2·4 groats to $1.
- 30 September 2015 – 2·0 groats to $1.
- 31 October 2015 – 2·1 groats to $1. (7 marks)

(c) On 1 October 2014, Delta granted share options to 100 senior executives. The options vest on 30 September 2017. The number of options granted per executive depend on the cumulative revenue for the three years ended 30 September 2017. Each executive will receive options as follows:

Cumulative revenue for the three years ended 30 September 2017	**Number of options PER EXECUTIVE**
Less than $180 million	Nil
At least $180 million but less than or equal to $270 million	200
More than $270 million	300

Delta's revenue for the year ended 30 September 2015 was $50 million. The directors of Delta have produced reliable budgets showing that the revenues of Delta for the next two years are likely to be:

- Year ended 30 September 2016 – $65 million.
- Year ended 30 September 2017 – $75 million.

On 1 October 2014, the fair value of these share options was $3 per option. This figure had increased to $3·60 per option by 30 September 2015 and was expected to be $5 per option by 30 September 2017. All of the 100 executives who were granted the options on 1 October 2014 were expected to remain as employees throughout the three-year period from 1 October 2014 to 30 September 2017. (4 marks)

Required:

Explain and show how the three events would be reported in the financial statements of Delta for the year ended 30 September 2015.

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

(20 marks)

DipIFR 15 Dec Questions

3 **(a)** IFRS 15 *Revenue from Contracts with Customers* was issued in 2014 and replaces the previous international financial reporting standard relating to revenue.

Required:

(i) Identify the five steps which need to be followed by entities when recognising revenue from contracts with a customer.

(ii) Explain how IFRS 15 is expected to improve the financial reporting of revenue. (5 marks)

(b) Kappa prepares financial statements to 30 September each year. During the year ended 30 September 2015, Kappa entered into the following transactions:

(i) On 1 September 2015, Kappa sold a machine to a customer. Kappa also agreed to service the machine for a two-year period from 1 September 2015 for no additional charge. The total amount payable by the customer for this arrangement was agreed to be:

– $800,000, if the customer paid by 31 December 2015.
– $810,000, if the customer paid by 31 January 2016.
– $820,000, if the customer paid by 28 February 2016.

The directors of Kappa consider that it is highly probable the customer will pay for the products in January 2016. The stand alone selling price of the machine was $700,000 and Kappa would normally expect to receive $140,000 in consideration for providing two years' servicing of the machine. The alternative amounts receivable are to be treated as variable consideration. (10 marks)

(ii) On 20 September 2015, Kappa sold 100 identical items to a customer for $2,000 each. The items cost Kappa $1,600 each to manufacture. The terms of sale are that the customer has the right to return the goods for a full refund within three months. After the three-month period has expired the customer can no longer return the goods and payment becomes immediately due. Kappa has entered into transactions of this type with this customer previously and can reliably estimate that 4% of the products are likely to be returned within the three-month period. (5 marks)

Required:

Explain and show how both these transactions would be reported in the financial statements of Kappa for the year ended 30 September 2015.

Note: The mark allocation is shown against both of the two transactions above.

(20 marks)

DipIFR 15 Dec Questions

4 You are the financial controller of Omega, a listed company which prepares consolidated financial statements in accordance with International Financial Reporting Standards (IFRS). Your managing director, who is not an accountant, has recently attended a seminar and has raised two questions for you concerning issues discussed at the seminar:

(a) One of the delegates at the seminar was a director of an entity which is involved in the exploration for, and evaluation of, mineral resources. This delegate told me that under IFRS rules it is possible for individual entities to develop their own policies for when to recognise the costs of exploration for and evaluation of mineral resources as assets. This seems very strange to me. Surely IFRS requires consistent treatment for all tangible and intangible assets so that financial statements are comparable. Please explain the position to me and outline the relevant requirements of IFRS regarding accounting for exploration and evaluation expenditures. (10 marks)

(b) Another delegate was discussing the fact that the entity of which she is a director is relocating its head office staff to a more suitable site and intends to sell its existing head office building. Apparently the existing building was advertised for sale on 1 July 2015 and the entity anticipates selling it by 31 December 2015. The year end of the entity is 30 September 2015. The delegate stated that in certain circumstances buildings which are intended to be sold are treated differently from other buildings in the financial statements. Please outline under what circumstances buildings which are being sold are treated differently and also what that different treatment is. (10 marks)

Required:

Provide answers to the questions raised by the managing director.

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

(20 marks)

End of Question Paper

DipIFR 15 Dec Questions

Diploma in International Financial Reporting

Tuesday 9 June 2015

Time allowed
Reading and planning: 15 minutes
Writing: 3 hours

ALL FOUR questions are compulsory and MUST be attempted.

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DipIFR 15 June Questions

ALL FOUR questions are compulsory and MUST be attempted

1 Alpha holds investments in two other entities, Beta and Gamma. The draft statements of financial position of the three entities at 31 March 2015 were as follows:

	Alpha $'000	Beta $'000	Gamma $'000
Assets			
Non-current assets:			
Property, plant and equipment (Notes 1 and 6)	300,000	240,000	180,000
Investments (Notes 1, 2 and 3)	267,000	40,000	10,000
	567,000	280,000	190,000
Current assets:			
Inventories (Note 4)	90,000	60,000	45,000
Trade receivables (Note 5)	72,000	46,000	40,000
Cash and cash equivalents	15,000	10,000	8,000
	177,000	116,000	93,000
Total assets	744,000	396,000	283,000
Equity and liabilities			
Equity			
Share capital ($1 shares)	200,000	150,000	120,000
Retained earnings (Notes 1 and 2)	367,500	115,000	51,000
Other components of equity (Notes 1, 2 and 3)	5,000	4,000	2,000
Total equity	572,500	269,000	173,000
Non-current liabilities:			
Provision (Note 6)	12,500	Nil	Nil
Long-term borrowings (Note 7)	60,000	45,000	50,000
Deferred tax	32,000	30,000	20,000
Total non-current liabilities	104,500	75,000	70,000
Current liabilities:			
Trade and other payables (Note 5)	45,000	42,000	33,000
Short term borrowings	22,000	10,000	7,000
Total current liabilities	67,000	52,000	40,000
Total equity and liabilities	744,000	396,000	283,000

Note 1 – Alpha's investment in Beta

On 1 April 2010, Alpha acquired 120 million shares in Beta by means of a cash payment of $234·5 million. Alpha also incurred directly attributable costs of $2·5 million associated with the acquisition of Beta and recognised the investment in its individual statement of financial position at $237 million. There has been no change to the carrying value of this investment in Alpha's own statement of financial position since 1 April 2010.

It is the group policy to value the non-controlling interest in subsidiaries at the date of acquisition at fair value. The market value of an equity share in Beta at 1 April 2010 can be used for this purpose. On 1 April 2010, the market value of a Beta share was $1·80.

On 1 April 2010, the individual financial statements of Beta showed the following reserves balances:

– Retained earnings $75 million.
– Other components of equity $1 million.

DipIFR 15 June Questions

The directors of Alpha carried out a fair value exercise to measure the identifiable assets and liabilities of Beta at 1 April 2010. The following matters emerged:

– Property having a carrying value of $150 million at 1 April 2010 (depreciable component $80 million) had an estimated market value of $180 million at that date (depreciable component $90 million). The estimated future economic life of the depreciable component at 1 April 2010 was 20 years. This property is included in Beta's statement of financial position at 31 March 2015.
– Plant and equipment having a carrying value of $110 million at 1 April 2010 had an estimated market value of $123 million at that date. Beta has disposed of all of this plant and equipment since 1 April 2010.

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%. No impairment of the goodwill on acquisition of Beta has occurred since 1 April 2010.

Note 2 – Alpha's investment in Gamma

On 1 July 2014, Alpha acquired 90 million shares in Gamma by means of a share exchange. Alpha issued two shares for every three shares acquired in Gamma. On 1 July 2014, the market value of an Alpha share was $2·90 and the market value of a Gamma share was $1·50. The share exchange has not been recorded in the draft financial statements of Alpha presented above. Alpha also incurred directly attributable costs of $1·5 million associated with this acquisition and debited these costs to administrative expenses in its draft statement of profit or loss for the year ended 31 March 2015.

On 1 April 2014, the individual financial statements of Gamma showed the following reserves balances:

– Retained earnings $45 million. The profits of Gamma for the year ended 31 March 2015 accrued evenly over the year.
– Other components of equity $2 million. See also the information provided in note 3 regarding other components of equity.

Gamma leases all of its properties on operating leases and its plant and equipment comprises assets with relatively short useful economic lives. Therefore on 1 July 2014, there were no material differences between the carrying values of the net assets of Gamma in the individual financial statements and the fair values of those net assets.

No impairment of the goodwill on acquisition of Gamma has occurred since 1 July 2014.

Note 3 – Other investments

Apart from its investment in Beta, the investments of Alpha included in the statement of financial position at 31 March 2015 are all financial assets which Alpha has elected to measure at fair value through other comprehensive income. All of the investments held by Beta and Gamma are also financial assets which Beta and Gamma have elected to measure at fair value through other comprehensive income. None of these investments have been bought or sold in the year ended 31 March 2015. The fair values which are included in the draft statements of financial position above are the fair values at 31 March 2014 for Beta and 1 July 2014 for Gamma. Relevant fair values as at 31 March 2015 were as follows:

– Alpha – $33 million.
– Beta – $43 million.
– Gamma – $11·6 million. The change in the fair value of Gamma's investments during the year ended 31 March 2015 was caused by events occurring AFTER 1 July 2014.

You do NOT need to consider the deferred tax implications of any gains arising on the remeasurement of these investments.

Note 4 – Inter-company sale of inventories

The inventories of Beta and Gamma at 31 March 2015 included components purchased from Alpha in the last three months of the financial year at a cost of $15 million to Beta and $10 million to Gamma. Alpha normally earns a profit margin of 30% on the sale of these components but supplies of these components to group companies are routinely made at a reduced margin of 20%.

In the consolidated financial statements, any adjustments required as a result of this note 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%. You can assume that sufficient taxable profits exist in each entity to allow the deferred tax implications of deductible temporary differences.

Note 5 – Trade receivables and payables

The trade receivables of Alpha included $9 million receivable from Beta and $6 million receivable from Gamma in respect of the purchase of components (see Note 4). On 30 March 2015, Beta and Gamma paid $9 million and $6 million respectively to Alpha and so eliminated their trade payables balance in respect of the purchase of components. Alpha recorded these receipts on 3 April 2015.

Note 6 – Provision

On 1 March 2015, the board of directors of Alpha finalised a plan to re-organise and reconstruct the group. The plan was publicly announced on 15 March 2015. The plan involved closing down one of Alpha's operating units – unit X (not a separate legal entity). The business of unit X will not be discontinued – the other operating units of Alpha will be able to supply the unit's existing customers. However, all of the property, plant and equipment being used in unit X will be disposed of. Some of the employees working in unit X will be made redundant, and others will be transferred to other operating units of Alpha.

The provision made by Alpha in its draft financial statements comprised the best estimate of the following:

	$ million
Redundancy costs	8
Costs of relocating employees to new locations	2·5
Costs of retraining existing employees for work at new locations	2·0
	12·5

On 15 March 2015, the property, plant and equipment of unit X, which is included in the above statement of financial position, had a total carrying value of $15 million. $12 million of this amount relates to property, and $3 million to plant and equipment. On 15 March 2015, all of the property, plant and equipment was offered for sale. The property was offered for sale at a price of $16·5 million, and the plant and equipment at $1·05 million. Both of these amounts are considered to be reasonable prices which are achievable within six months of the year end. The estimated costs of disposal of the property are $500,000 and the costs of disposal of the plant $50,000. However, none of the property, plant and equipment of unit X which was being offered for sale had actually been sold by 31 March 2015. You can assume that any change in carrying value of this property, plant and equipment between 15 and 31 March 2015 is immaterial.

Note 7 – Long-term borrowings

On 31 March 2015, Alpha issued 30 million $1 convertible loan notes. The loan notes carry a coupon rate of 6% per annum payable annually in arrears and are redeemable at par on 31 March 2020. As an alternative to redemption, the loan note holders can elect to exchange their loan notes for equity shares in Alpha on 31 March 2020. If the option to exchange were not available, the investors in the loan notes would have required a return on their investment of 10% per annum.

Discount factors which may be relevant are as follows:

	Discount rate	
	6%	10%
	$	$
Present value of $1 receivable in 5 years	0·747	0·621
Cumulative present value of $1 receivable at the end of years 1–5	4·212	3·790

On 31 March 2015, Alpha debited cash and credited long-term borrowings with $30 million in respect of this loan.

Required:

Prepare the consolidated statement of financial position of Alpha at 31 March 2015.

(40 marks)

DipIFR 15 June Questions

2 Delta is an entity which prepares financial statements to 31 March each year. The financial statements for the year ended 31 March 2015 are to be authorised for issue on 30 June 2015. The following events are relevant to these financial statements:

(a) On 1 April 2014, Delta purchased 1 million options to acquire shares in Epsilon, a listed entity. Delta paid 25c per option, which allows Delta to purchase shares in Epsilon for a price of $2 per share. The exercise date for the options was 31 December 2014. On 31 December 2014, when the market value of a share in Epsilon was $2·60, Delta exercised all its options to acquire shares in Epsilon. In addition to the purchase price, Delta incurred directly attributable acquisition costs of $100,000 on the purchase of the 1 million shares in Epsilon. Delta regarded the shares it purchased in Epsilon as part of its trading portfolio. However, Delta did not dispose of any of the shares in Epsilon between 31 December 2014 and 31 March 2015. On 31 March 2015, the market value of a share in Epsilon was $2·90. (9 marks)

(b) On 1 April 2014, Delta sold a property for $48 million to raise cash to expand its business. The carrying value of the property on 1 April 2014 was $50 million and its fair value was $55 million. The estimated future useful life of the property on 1 April 2014 was 40 years. On 1 April 2014, Delta began to lease this property on a 10 year lease. The annual lease rentals for the first five years of the lease were set at $1 million. For the final five years of the lease, the rentals were set at $1·5 million. Both of these rental amounts were below the market rental for a property of this nature. (7 marks)

(c) On 31 March 2015, the inventories of Delta included a consignment of components which Delta had been supplying to a number of different customers for some years. The cost of the consignment was $10 million and based on retail prices at 31 March 2015, the expected selling price of the consignment would have been $12 million. On 15 May 2015, a competitor completed the development of an alternative component which seems likely to make Delta's consignment obsolete. The directors of Delta estimate that the consignment (all still currently unsold) will now be sold for only $2 million. (4 marks)

Required:

Explain and show how the three events should be reported in the financial statements of Delta for the year ended 31 March 2015.

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

(20 marks)

DipIFR 15 June Questions

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Question 3 begins on page 8.

3 **(a)** IFRS 2 – *Share-based Payment* – defines a share-based payment transaction as one in which an entity receives goods or services from a third party (including an employee) in a share-based payment arrangement. A share-based payment arrangement is an agreement between an entity and a third party which entitles the third party to receive either:

– Equity instruments of the entity (equity-settled share-based payments); or
– Cash or other assets based on the price of equity instruments of the entity (cash-settled share-based payments).

Share-based payment arrangements are often subject to vesting conditions which must be satisfied over a vesting period.

Required:

For both cash-settled AND equity-settled share-based payment arrangements, explain:

(i) The basis on which the arrangements should be measured;
(ii) The criteria which are used to allocate the total value of the arrangement to individual accounting periods;
(iii) The accounting entries (debit and credit) required during the vesting period. (6 marks)

(b) Kappa prepares financial statements to 31 March each year. The following share-based payment arrangements were in force during the year ended 31 March 2015:

(i) On 1 April 2013, Kappa granted options to 500 employees to subscribe for 400 shares each in Kappa on 31 March 2017, providing the employees still worked for Kappa at that time. On 1 April 2013, the fair value of each option was $1·50.

In the year ended 31 March 2014, ten of these employees left Kappa and at 31 March 2014, Kappa expected that 20 more would leave in the three-year period from 1 April 2014 to 31 March 2017. Kappa's results for the year ended 31 March 2014 were below expectations and at 31 March 2014 the fair value of each option had fallen to 25 cents. Therefore, on 1 April 2014 Kappa amended the exercise price of the original options. This amendment caused the fair value of these options to rise from 25 cents to $1·45.

During the year ended 31 March 2015, five of the employees left and at 31 March 2015, Kappa expected that ten more would leave in the two-year period from 1 April 2015 to 31 March 2017. The results of Kappa for the year ended 31 March 2015 were much improved and at 31 March 2015, the fair value of a re-priced option was $1·60. (9 marks)

(ii) On 1 April 2013, Kappa granted share appreciation rights to 50 senior employees. The number of rights to which each employee becomes entitled depends on the cumulative profit of Kappa for the three years ended 31 March 2016:

– 1,000 rights per employee are awarded if the cumulative profit for the three-year period is below $500,000.
– 1,500 rights per employee are awarded if the cumulative profit for the three-year period is between $500,000 and $1 million.
– 2,000 rights per employee are awarded if the cumulative profit for the three-year period exceeds $1 million.

On 1 April 2013, Kappa expected that the cumulative profits for the three-year period would be $800,000. After the disappointing financial results for the year ended 31 March 2014, this estimate was revised at that time to $450,000. However, given the improvement in results for the year ended 31 March 2015, the estimate was revised again at 31 March 2015 to $1,100,000.

On 1 April 2013, the fair value of one share appreciation right was $1·10. This estimate was revised to $0·90 at 31 March 2014 and to $1·20 at 31 March 2015. All the senior employees are expected to remain employed by Kappa for the relevant three-year period. The rights are exercisable on 30 June 2016.
(5 marks)

Required:

Show how and where transactions (i) and (ii) would be reported in the financial statements of Kappa for the year ended 31 March 2015.

Note: The mark allocation is shown against both of the two transactions above.

Ignore deferred tax.

(20 marks)

DipIFR 15 June Questions

4 You are the financial controller of Omega, a listed company which prepares consolidated financial statements in accordance with International Financial Reporting Standards (IFRS). Your managing director, who is not an accountant, has recently attended a seminar and has the following questions for you concerning issues raised at the seminar:

(a) One of the delegates at the seminar was a director of an entity which operates a number of different farms. She informed me that there was a financial reporting standard which applied to farming entities. I think she said it was IAS 41. I'd like to know why a special standard is needed for farming entities. Given that we have IAS 41, does this mean that other IFRSs do not apply to farming entities? Please explain the main recognition and measurement requirements of IAS 41 – I'm not interested in details about disclosures. I am interested, though, in any areas where the provisions of IAS 41 differ from general IFRSs. I believe I heard that farming entities treat grants from the government in a different way than other entities do. I'm particularly interested to hear about this – assuming I'm correct. (12 marks)

(b) Another delegate, a director of a relatively small listed entity, stated that his entity did not need to comply with the detailed requirements of IFRS because of the relatively small size of the entity. Is it true that there are different accounting rules which are available for smaller entities? Can his entity take advantage of them? Please give me an outline explanation – I don't need the details of any different rules. (8 marks)

Required:

Provide answers to the questions raised by the managing director.

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

(20 marks)

End of Question Paper

DipIFR 15 June Questions

DipIFR

Diploma in International Financial Reporting

Friday 9 December 2016

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

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The question paper begins on page 3.

DipIFR 16 Dec Questions

ALL FOUR questions are compulsory and MUST be attempted

1 Alpha holds investments in two entities, Beta and Gamma. The draft statements of financial position of the three entities at 30 September 2016 were as follows:

	Alpha $'000	Beta $'000	Gamma $'000
Assets			
Non-current assets:			
Property, plant and equipment (Notes 1 and 3)	524,000	370,000	162,000
Investments (Notes 1 and 3)	423,000	Nil	Nil
	947,000	370,000	162,000
Current assets:			
Inventories	120,000	75,000	60,000
Trade receivables (Note 4)	90,000	66,000	55,000
Cash and cash equivalents	15,000	12,000	10,000
	225,000	153,000	125,000
Total assets	1,172,000	523,000	287,000
Equity and liabilities			
Equity			
Share capital ($1 shares)	140,000	100,000	80,000
Retained earnings (Notes 1 and 3)	573,000	210,000	90,000
Other components of equity (Notes 1 and 3)	250,000	10,000	Nil
Total equity	963,000	320,000	170,000
Non-current liabilities:			
Provisions (Note 5)	1,250	Nil	Nil
Long-term borrowings	82,750	90,000	48,000
Deferred tax	45,000	28,000	30,000
Total non-current liabilities	129,000	118,000	78,000
Current liabilities:			
Trade and other payables	60,000	50,000	30,000
Short-term borrowings	20,000	35,000	9,000
Total current liabilities	80,000	85,000	39,000
Total equity and liabilities	1,172,000	523,000	287,000

Note 1 – Alpha's investment in Beta

On 1 October 2013, Alpha acquired 80 million shares in Beta by means of a share exchange of one share in Alpha for every two shares acquired in Beta. On 1 October 2013, the market value of an Alpha share was $7·00.

Alpha incurred directly attributable due diligence costs of $3 million on acquisition of Beta. The directors of Alpha included these acquisition costs in the carrying amount of the investment in Beta in the draft statement of financial position of Alpha. There has been no change to the carrying amount of this investment in Alpha's own statement of financial position since 1 October 2013.

On 1 October 2013, the individual financial statements of Beta showed the following balances:

– Retained earnings $150 million.
– Other components of equity $5 million.

DipIFR 16 Dec Questions

The directors of Alpha carried out a fair value exercise to measure the identifiable assets and liabilities of Beta at 1 October 2013. The following matters emerged:

– Property having a carrying amount of $160 million (land component $70 million, buildings component $90 million) had an estimated fair value of $200 million (land component $80 million, buildings component $120 million). The buildings component of the property had an estimated useful life of 30 years at 1 October 2013.

– Plant and equipment having a carrying amount of $120 million had an estimated fair value of $140 million. The estimated remaining useful life of this plant at 1 October 2013 was four years. None of this plant and equipment had been disposed of between 1 October 2013 and 30 September 2016.

– On 1 October 2013, the notes to the financial statements of Beta disclosed a contingent liability. On 1 October 2013, the fair value of this contingent liability was reliably measured at $6 million. The contingency was resolved in the year ended 30 September 2014 and no payments were required to be made by Beta in respect of this contingent liability.

– 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%.

The directors of Alpha used the proportion of net assets method when measuring the non-controlling interest in Beta in the consolidated statement of financial position.

Note 2 – Impairment review of goodwill on acquisition of Beta

No impairment of the goodwill on acquisition of Beta was evident when the reviews were carried out on 30 September 2014 and 2015. On 30 September 2016, the directors of Alpha carried out a further review and concluded that the recoverable amount of the net assets of Beta at that date was $400 million. Beta is regarded as a single cash generating unit for the purpose of measuring goodwill impairment.

Note 3 – Alpha's investment in Gamma

On 1 October 2015, Alpha acquired 60 million shares in Gamma by means of a cash payment of $140 million. The purchase agreement provided for an additional payment on 31 October 2017 to the former holders of the 60 million acquired shares. The amount of this additional payment is dependent on the financial performance of Gamma in the two-year period from 1 October 2015 to 30 September 2017. On 1 October 2015, the fair value of this additional payment was estimated to be $20 million. This estimate was revised to $24 million on 30 September 2016. Alpha has not made any entries in its draft financial statements to record this potential additional payment.

On 1 October 2015, the individual financial statements of Gamma showed a balance on retained earnings of $75 million.

On 1 October 2015, the fair values of the net assets of Gamma were the same as their carrying amounts with the exception of some land which had a carrying amount of $50 million and a fair value of $70 million. This land continued to be an asset of Gamma at 30 September 2016. The fair value adjustment has not been reflected in the individual financial statements of Gamma. In the consolidated financial statements the fair value adjustment 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 impairment issues arose concerning the measurement of Gamma in the consolidated statement of financial position of Alpha at 30 September 2016.

The directors of Alpha used the full goodwill (fair value) method when measuring the non-controlling interest in Gamma in the consolidated statement of financial position. On 1 October 2015, the fair value of a share in Gamma was $2·30.

Note 4 – Trade receivables and payables

Group policy is to clear intra-group balances on a given date prior to each year end. Beta complied with this policy at 30 September 2016 but Gamma was late in making the required payment of $10 million to Alpha. The payment was made by Gamma on 29 September 2016 and received and recorded by Alpha on 2 October 2016.

DipIFR 16 Dec Questions

Note 5 – Provision

On 1 October 2015, Alpha completed the construction of a non-current asset with an estimated useful life of 20 years. The costs of construction were recognised in property, plant and equipment and depreciated appropriately. Alpha has a legal obligation to restore the site on which the non-current asset is located on 30 September 2035. The estimated cost of this restoration work, at 30 September 2035 prices, is $25 million. The directors of Alpha have made a provision of $1·25 million (1/20 x $25 million) in the draft statement of financial position at 30 September 2016. An appropriate annual discount rate to use in any relevant calculations is 6% and at this rate the present value of $1 payable in 20 years is 31·2 cents.

Required:

Prepare the consolidated statement of financial position of Alpha at 30 September 2016. You need only consider the deferred tax implications of any adjustments you make where the question specifically refers to deferred tax.

(40 marks)

DipIFR 16 Dec Questions

2 Delta is an entity which prepares financial statements to 30 September each year. The financial statements for the year ended 30 September 2016 are shortly to be authorised for issue. The following events are relevant to these financial statements:

(a) On 1 October 2014, Delta purchased an asset for $20 million. The estimated useful life of the asset was 10 years, with an estimated residual value of zero. Delta immediately leased the asset to Epsilon. The lease term was 10 years and the annual rental, payable in advance by Epsilon, was $2,787,000. Delta incurred direct costs of $200,000 in arranging the lease. The lease contained no early termination clauses and responsibility for repairs and maintenance of the asset rest with Epsilon for the duration of the lease. The directors of Delta correctly computed the annual rate of interest implicit in the lease as 8%. At an annual discount rate of 8% the present value of $1 receivable at the start of years 1–10 is $7·247. (8 marks)

(b) On 1 September 2016, Delta sold a product to Customer X. Customer X is based in a country whose currency is the florin and Delta has a large number of customers in that country to whom Delta sell similar products. The invoiced price of the product was 500,000 florins. The terms of the sale gave the customer the right to return the product at any time in the two-month period ending on 31 October 2016. On 1 September 2016, Delta estimated that there was a 22% chance the product would be returned during the two-month period. The product had not been returned to Delta by 15 October 2016 (the date the financial statements for the year ended 30 September 2016 were authorised for issue). On 15 October 2016, the directors estimated that there was an 8% chance the product would be returned before 31 October 2016. The directors of Delta considered that the most reliable method of measuring the price for this transaction was to estimate any variable consideration using a probability (expected value) approach. Exchange rates (florins to $1) are as follows:

- 1 September 2016 – 2 florins to $1.
- 30 September 2016 – 2·1 florins to $1.
- 15 October 2016 – 2·15 florins to $1.
- 31 October 2016 – 2·2 florins to $1. (7 marks)

(c) On 1 October 2014, Delta granted 250 share appreciation rights to 100 senior executives. The rights vest on 30 September 2017 provided the executives remain with Delta for the three-year period from 1 October 2014 to 30 September 2017. The rights can be exercised from 30 November 2017 to 31 December 2017. On 1 October 2014, it was expected that 10 executives would leave over the three-year period from 1 October 2014 to 30 September 2017. This estimate was confirmed on 30 September 2015 but two executives left unexpectedly during the year ended 30 September 2016 and Delta now expects that 12 executives will leave over the three-year period ending on 30 September 2017. Delta further estimated that all executives who were eligible to exercise the rights would do so. On 1 October 2014, the fair value of a share appreciation right was $3·20. The fair value increased to $3·50 by 30 September 2015 and to $3·60 by 30 September 2016.
(5 marks)

Required:

Explain and show how the three events would be reported in the financial statements of Delta for the year ended 30 September 2016.

Notes:
1. The mark allocation is shown against each of the three events above.
2. In explaining event (b), you do not need to consider the impact on inventory and cost of sales.

(20 marks)

DipIFR 16 Dec Questions

3 **(a)** One of the matters addressed in IFRS 9 – *Financial Instruments* is the initial and subsequent measurement of financial assets. IFRS 9 requires that financial assets are initially measured at their fair value at the date of initial recognition. However, subsequent measurement of financial assets depends on their classification for which IFRS 9 identifies three possible alternatives.

Required:

Explain the three classifications which IFRS 9 identifies for financial assets and the basis of measurement which is appropriate for each classification. You should also identify any exceptions to the normal classifications which may apply in specific circumstances. (8 marks)

(b) Kappa prepares financial statements to 30 September each year. During the year ended 30 September 2016 Kappa entered into the following transactions:

(i) On 1 October 2015, Kappa made an interest free loan to an employee of $800,000. The loan is due for repayment on 30 September 2017 and Kappa is confident that the employee will repay the loan. Kappa would normally require an annual rate of return of 10% on business loans (5 marks)

(ii) On 1 October 2015, Kappa made a three-year loan of $10 million to entity X. The rate of interest payable on the loan was 8% per annum, payable in arrears. On 30 September 2018, Kappa will receive a fixed number of shares in entity X in full settlement of the loan. Entity X paid the interest due of $800,000 on 30 September 2016 and entity X has no liquidity problems. Following payment of this interest, the fair value of this loan asset at 30 September 2016 was estimated to be $10·5 million. (4 marks)

(iii) On 1 October 2015, Kappa purchased an equity investment in entity Y for $12 million. The investment did not give Kappa control or significant influence over entity Y but the investment is seen as a long-term one. On 30 September 2016, the fair value of Kappa's investment in entity Y was estimated to be $13 million. (3 marks)

Required:

Explain and show how the above transactions would be reported in the financial statements of Kappa for the year ended 30 September 2016.

Note: The mark allocation for part (b) is shown against each of the three transactions above.

(20 marks)

DipIFR 16 Dec Questions

4 You are the financial controller of Omega, a listed entity which prepares consolidated financial statements in accordance with International Financial Reporting Standards (IFRS). You have recently produced the final draft of the financial statements for the year ended 30 September 2016 and these are due to be published shortly. The managing director, who is not an accountant, reviewed these financial statements and prepared a list of queries arising out of the review.

Query One

One of the notes to the financial statements gives details of purchases made by Omega from entity X during the period. I own 100% of the shares in entity X but I do not understand why it is necessary for any disclosure whatsoever to be made in the Omega financial statements. The transaction is carried out on normal commercial terms and is totally insignificant to Omega, representing less than 1% of Omega's purchases. (5 marks)

Query Two

The notes to the financial statements say that plant and equipment is held under the 'cost model'. However, property which is owner occupied is revalued annually to fair value. Changes in fair value are sometimes reported in profit or loss but usually in 'other comprehensive income'. Also, the amount of depreciation charged on plant and equipment as a percentage of its carrying amount is much higher than for owner occupied property. Another note says that property we own but rent out to others is not depreciated at all but is revalued annually to fair value. Changes in value of these properties are always reported in profit or loss. I thought we had to be consistent in our treatment of items in the accounts. Please explain how all these treatments comply with relevant reporting standards. (7 marks)

Query Three

As you know, in the year to September 2016 we spent considerable sums of money designing a new product. We spent the six months from October 2015 to March 2016 researching into the feasibility of the product. We charged these research costs to profit or loss. From April 2016, we were confident that the product would be commercially successful and we fully committed ourselves to financing its future development. We spent most of the rest of the year developing the product, which we will begin to sell in the next few months. These development costs have been recognised as intangible assets in our statement of financial position. How can this be right when all these research and development costs are design costs? Please justify this with reference to relevant reporting standards.

(5 marks)

Query Four

On reviewing our financial statements, I found a note giving information about the different segments of our business and also the disclosure of the earnings per share of our entity. Neither the segment note nor the earnings per share disclosure appears in the financial statements of entity X (see query 1 above). Even though entity X is unlisted, both entities report under full International Financial Reporting Standards so I do not understand how this difference can occur. Please explain this to me. (3 marks)

Required:

Provide answers to the queries raised by the managing director.

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

(20 marks)

End of Question Paper

DipIFR 16 Dec Questions

Diploma in International Financial Reporting

Friday 10 June 2016

Time allowed
Reading and planning: 15 minutes
Writing: 3 hours

ALL FOUR questions are compulsory and MUST be attempted.

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

During reading and planning time only the question paper may be annotated. You must NOT write in your answer booklet until instructed by the supervisor.

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

DipIFR

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ALL FOUR questions are compulsory and MUST be attempted

1 Alpha's investments include subsidiaries, 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 2016 were as follows:

Statements of profit or loss and other comprehensive income

	Alpha	Beta	Gamma
	$'000	$'000	$'000
Revenue (Notes 3 and 4)	360,000	210,000	190,000
Cost of sales (Notes 1–3)	(240,000)	(110,000)	(100,000)
Gross profit	120,000	100,000	90,000
Distribution costs	(20,000)	(16,000)	(15,000)
Administrative expenses	(30,000)	(19,000)	(18,000)
Investment income (Notes 5 and 6)	19,800	Nil	Nil
Finance costs (Note 7)	(12,000)	(17,000)	(13,000)
Profit before tax	77,800	48,000	44,000
Income tax expense	(15,000)	(12,000)	(11,000)
Profit for the year	62,800	36,000	33,000
Other comprehensive income:			
Items that will not be reclassified to profit or loss			
Gains/(losses) on financial assets designated at fair value through other comprehensive income (Note 5)	Nil	Nil	Nil
Total comprehensive income	62,800	36,000	33,000

Summarised statements of changes in equity

	Alpha	Beta	Gamma
Balance on 1 April 2015	200,000	150,000	130,000
Comprehensive income for the year	62,800	36,000	33,000
Dividends paid on 31 December 2015	(30,000)	(12,000)	(11,000)
Balance on 31 March 2016	232,800	174,000	152,000

Note 1 – Alpha's investment in Beta

On 1 April 2004, Alpha acquired 80% of the equity shares of Beta and gained control of Beta. Alpha paid $64 million in cash for these shares.

On 1 April 2004, the net assets of Beta had a fair value of $70 million. None of the assets and liabilities of Beta which existed on 1 April 2004 were still assets or liabilities of Beta on 31 March 2015.

Alpha measured the non-controlling interest in Beta using the proportion of net assets method. The resulting goodwill on acquisition of Beta was correctly recognised in the consolidated financial statements of Alpha. No impairment of goodwill on acquisition of Beta has been necessary up to and including 31 March 2015.

On 31 March 2016, the annual impairment review of the goodwill on acquisition of Beta indicated that the recoverable amount of the total net assets of Beta (including the goodwill) at that date was $180 million. Beta is regarded as a single cash generating unit for impairment purposes. Any impairment of goodwill should be charged to cost of sales.

Note 2 – Alpha's investment in Gamma

On 1 October 2015, Alpha acquired 60% of the equity shares in Gamma and gained control of Gamma. Gamma had 50 million equity shares in issue on 1 October 2015 and has not issued any new shares since that date. The acquisition was financed as follows:

– Alpha issued two new shares to the former shareholders of Gamma for every three shares Alpha acquired in Gamma. On 1 October 2015, the fair value of an equity share in Alpha was $2·80 and the fair value of an equity share in Gamma was $3·70.

– Alpha agreed to pay a total of $24·2 million to the former shareholders of Gamma on 30 September 2017. Alpha's incremental borrowing rate at 1 October 2015 was 10% per annum.

– Alpha agreed to pay a further amount to the former shareholders of Gamma on 31 December 2019 if the cumulative profits of Gamma for the four-year period from 1 October 2015 to 30 September 2019 exceed $150 million. On 1 October 2015, the fair value of this obligation was measured at $40 million. On 31 March 2016, this fair value was remeasured at $42 million.

Alpha has resolved to use 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 October 2015 can be used for this purpose. No impairment of the goodwill on acquisition of Gamma is necessary in the consolidated financial statements of Alpha for the year ended 31 March 2016.

On 1 October 2015, the fair values of the net assets of Gamma were the same as their carrying amounts in the financial statements of Gamma with the exception of:

– Property – whose fair value exceeded the carrying amount by $25 million ($10 million of this excess relates to land). The estimated remaining useful life of the buildings element of the property at 1 October 2015 was 20 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 October 2015 was four years.

All depreciation of property, plant and equipment is charged to cost of sales. You can assume that the profit of Gamma for the year ended 31 March 2016 accrued evenly over the year.

Note 3 – Intra-group trading

Alpha supplies a component used by both Beta and Gamma. Alpha earns a profit margin of 10% on these supplies. Details of the sales of the component, and the holdings of inventory of the component by group entities, are as follows:

	Beta $'000	Gamma $'000
Sales of the component (for Gamma all sales since 1 October 2015)	15,000	8,000
Inventory of component at 31 March 2015 (at cost to Beta/Gamma	2,000	Nil
Inventory of component at 31 March 2016 (at cost to Beta/Gamma)	3,000	2,800

Note 4 – Revenue of Alpha

On 1 October 2015, Alpha sold a large machine to a customer for a total price of $51·2 million and credited $51·2 million to revenue. As part of the sales agreement, Alpha agreed to provide annual servicing of the machine for four years from 1 October 2015 for no additional payment. The normal selling price of this without any annual servicing would have been $60 million and Alpha would normally charge the customer an annual fee of $1 million to service the machine. You should ignore the time value of money in respect of this transaction.

Note 5 – Alpha's other investment

Apart from its investments in Beta and Gamma, Alpha has one other investment – in entity X. Alpha purchased this equity investment on 1 July 2015 for $40 million and designated the investment as fair value through other comprehensive income. In order to protect against a prolonged decline in the fair value of the investment in entity X, Alpha purchased a put option to sell this investment. The cost of the option was $6 million and the option was regarded as an effective hedge against a prolonged decline in the fair value of the investment in entity X. On 31 March 2016, the fair value of the equity investment in entity X was $37 million and the fair value of the put option was $8·7 million. Apart from recognising the investment in entity X and the put option at cost, Alpha has made no other entries in its draft financial statements. Alpha wishes to use hedge accounting whenever permitted by International Financial Reporting Standards.

Note 6 – Investment income

All of the investment income of Alpha has been correctly recognised in the individual financial statements of Alpha.

Note 7 – Bond issue

On 1 April 2015, Alpha issued a convertible zero-coupon bond to a single institutional investor. The bond was issued for total proceeds of $250 million and will be redeemed or converted into equity shares on 31 March 2020. If the

DipIFR 16 June Questions

investor chooses to redeem the bond on 31 March 2020, the investor will receive $362·32million. The incremental borrowing rate of Alpha on 1 April 2015 is 10% per annum. The present value of $1 received in five years at a discount rate of 10% per annum is 62·1 cents.

Required:

(a) Using the information in notes 1 and 2, compute the goodwill arising on the acquisitions of Beta at 1 April 2004 and Gamma at 1 October 2015. (8 marks)

(b) Prepare the consolidated statement of profit or loss and other comprehensive income of Alpha for the year ended at 31 March 2016. You do not need to consider the deferred tax effects of any adjustments you make. (25 marks)

(c) Prepare the summarised consolidated statement of changes in equity of Alpha for the year ended 31 March 2016, including a column for the non-controlling interest. (7 marks)

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. Each year the financial statements are authorised for issue on 20 May. The following events are relevant to the year ended 31 March 2016:

Event (a)

On 1 April 2014, Delta granted 2,000 employees 1,000 share options each. The options are due to vest on 31 March 2017 provided the relevant employees remain in employment over the three-year period ending on 31 March 2017.

On 1 April 2014, the directors of Delta estimated that 1,800 employees would qualify for the options on 31 March 2017. This estimate was amended to 1,850 employees on 31 March 2015, and further amended to 1,840 employees on 31 March 2016.

On 1 April 2014, the fair value of an option was $1·20. The fair value increased to $1·30 by 31 March 2015 but, due to challenging trading conditions, the fair value declined after 31 March 2015. On 30 September 2015, when the fair value of an option was 90 cents, the directors repriced the options and this caused the fair value to increase to $1·05. Trading conditions improved in the second half of the year and by 31 March 2016 the fair value of an option was $1·25. Any additional costs that have occurred as a result of the repricing of the options on 30 September 2015 should be spread over the remaining vesting period from 30 September 2015 to 31 March 2017. (9 marks)

Event (b)

On 1 August 2015, Delta supplied some products it had manufactured to customer C. The products were faulty and on 1 October 2015 C commenced legal action against Delta claiming damages in respect of losses due to the supply of the faulty products. Upon investigating the matter, Delta discovered that the products were faulty due to defective raw materials supplied to Delta by supplier S. Therefore on 1 December 2015, Delta commenced legal action against S claiming damages in respect of the supply of defective materials. Since that date Delta has consistently estimated that it is probable that both of the legal actions, the action of C against Delta and the action of Delta against S, will succeed.

On 1 October 2015, Delta estimated that the damages Delta would have to pay to C would be $5 million. This estimate was updated to $5·2 million as at 31 March 2016 and $5·25 million as at 15 May 2016. This case was eventually settled on 1 June 2016, when Delta was required to pay damages of $5·3 million to C.

On 1 December 2015, Delta estimated that they would receive damages of $3·5 million from S. This estimate was updated to $3·6 million as at 31 March 2016 and $3·7 million as at 15 May 2016. This case was eventually settled on 1 June 2016, when S was required to pay damages of $3·75 million to Delta. (6 marks)

Event (c)

On 1 June 2015, the spouse of one of the directors of Delta purchased a controlling interest in entity X, a long-standing customer of Delta. Sales of products from Delta to entity X in the two-month period from 1 April 2015 to 31 May 2015 totalled $800,000. Following the share purchase by the spouse of one of the directors of Delta on 1 June 2015, Delta began to supply the products at a discount of 20% to their normal selling price and allow entity X three months' credit (previously entity X was only allowed one month's credit, Delta's normal credit policy). Sales of products from Delta to entity X in the ten-month period from 1 June 2015 to 31 March 2016 totalled $6 million. On 31 March 2016, the trade receivables of Delta included $1·8 million in respect of amounts owing by entity X.

(5 marks)

Required:

Explain and show (where possible by quantifying amounts) how the three events would be reported in the financial statements of Delta for the year ended 31 March 2016.

Note: The mark allocation is shown against each of the three events above. You should assume that all amounts described here are material. When discussing event (a), you are not required to consider disclosure requirements.

(20 marks)

DipIFR 16 June Questions

3 **(a)** A deferred tax liability is the amount of income tax payable in respect of taxable temporary differences. A deferred tax asset is the amount of income tax recoverable in future periods in respect of deductible temporary differences. A temporary difference is the difference between the carrying amount of an asset or liability in the statement of financial position and its tax base.

Required:

(i) Define the tax base of an asset as outlined in IAS 12 – *Income Taxes*. Use your definition to compute the tax base of the following assets:

- **A machine was purchased during the current accounting period for $250,000. Depreciation of $50,000 was charged in arriving at the accounting profit for the current period. A deduction of $100,000 was given against taxable profits by the local tax authorities against the taxable profits of the current period. The remaining cost will be deductible in future periods, either as depreciation or as a deduction on disposal.**
- **A current asset of $60,000 relates to interest receivable. The related interest revenue will be taxed on a cash basis when it is received.** (4 marks)

(ii) Define the tax base of a liability as outlined in IAS 12. Use your definition to compute the tax base of the following liabilities:

- **$120,000 is included in trade payables. This amount relates to purchases which qualified for a tax deduction when the purchase was made.**
- **$40,000 is included in accrued liabilities. A tax deduction relating to this liability will be given when the liability is settled.** (4 marks)

(b) Epsilon prepares financial statements to 31 March each year. The rate of income tax applicable to Epsilon is 20%. The following information relates to transactions, assets and liabilities of Epsilon during the year ended 31 March 2016:

(i) Epsilon has an investment property which it carries under the fair value model. The property originally cost $30 million. The property had an estimated fair value of $35 million on 31 March 2015 and $38 million on 31 March 2016. In the tax jurisdiction in which Epsilon operates, gains on the fair value of investment properties are not subject to income tax until the properties are disposed of.

(ii) Epsilon has a 40% shareholding in Lambda. Epsilon purchased this shareholding for $45 million. The shareholding gives Epsilon significant influence over Lambda but not control and therefore Epsilon accounts for its interest in Lambda using the equity method. The equity method carrying value of Epsilon's investment in Lambda was $70 million on 31 March 2015 and $75 million on 31 March 2016. In the tax jurisdiction in which Epsilon operates, profits recognised under the equity method are taxed if and when they are distributed as a dividend or the relevant investment is disposed of.

(iii) Epsilon measures its head office property using the revaluation model. The property is revalued every year on 31 March. On 31 March 2015, the carrying value of the property (after revaluation) was $40 million and its tax base was $22 million. During the year ended 31 March 2016, Epsilon charged depreciation in its statement of profit or loss of $2 million and claimed a tax deduction for tax depreciation of $1·25 million. On 31 March 2016, the property was revalued to $45 million. In the tax jurisdiction in which Epsilon operates, revaluation of property, plant and equipment does not affect taxable income at the time of revaluation.

Required:

Assuming that there are no other temporary differences other than those indicated above, compute:

- **The deferred tax liability of Epsilon at 31 March 2016.**
- **The charge or credit to both profit or loss and other comprehensive income relating to deferred tax for the year ended 31 March 2016.**

You should include brief explanations to support your computations. (12 marks)

(20 marks)

DipIFR 16 June Questions

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 managing director, who is not an accountant, has recently attended a business seminar at which financial reporting issues were discussed. Following the seminar, she reviewed the financial statements of Omega for the year ended 31 March 2016. Based on this review she has prepared a series of queries relating to those statements:

Query One

'One of the issues discussed at the seminar was 'impairment of financial assets'. On reviewing our financial statements I have noticed that we have two types of financial assets – Type A (those measured at amortised cost) and Type B (those measured at 'fair value through profit or loss'). It appears we carry out impairment reviews of Type A assets but not Type B assets. Please explain to me why this is the case and also please explain exactly how an impairment review of Type A assets is carried out.' (8 marks)

Query Two

'Another issue discussed at the seminar was financial reporting by farming entities. The issue of 'biological assets' was mentioned. I don't really understand what these are or how they're recognised and measured in the financial statements. Please explain this to me.' (5 marks)

Query Three

'During a break-out session I heard someone talking about accounting policies and accounting estimates. He said that when there's a change of these items sometimes the change is made retrospectively and sometimes it's made prospectively. Please explain the difference between an accounting policy and an accounting estimate and give me an example of each. Please also explain the difference between retrospective and prospective adjustments and how this applies to accounting policies and accounting estimates.' (7 marks)

Required:

Provide answers to the three questions raised by the managing director. 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

DipIFR 16 June Questions

Diploma in International Financial Reporting

Friday 8 December 2017

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.

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DipIFR 17 Dec Questions

ALL FOUR questions are compulsory and MUST be attempted

1 Alpha has two subsidiaries, Beta and Gamma. The draft statements of financial position of the three entities at 30 September 2017 are as follows:

	Alpha $'000	Beta $'000	Gamma $'000
Assets			
Non-current assets:			
Property, plant and equipment (Note 2)	610,000	310,000	160,000
Investments (Note 1)	370,700	Nil	Nil
	980,700	310,000	160,000
Current assets:			
Inventories (Note 3)	140,000	85,000	66,000
Trade receivables	95,000	70,000	59,000
Cash and cash equivalents	16,000	13,000	11,000
	251,000	168,000	136,000
Total assets	1,231,700	478,000	296,000
Equity and liabilities			
Equity:			
Share capital ($1 shares)	240,000	120,000	100,000
Retained earnings	550,700	168,000	59,000
Other components of equity (Notes 2, 6 and 7)	202,000	Nil	Nil
Total equity	992,700	288,000	159,000
Non-current liabilities:			
Long-term borrowings (Note 7)	100,000	70,000	60,000
Deferred tax	59,000	38,000	35,000
Total non-current liabilities	159,000	108,000	95,000
Current liabilities:			
Trade and other payables	60,000	52,000	32,000
Short-term borrowings	20,000	30,000	10,000
Total current liabilities	80,000	82,000	42,000
Total equity and liabilities	1,231,700	478,000	296,000

Note 1 – Summary of Alpha's investments

The investments figure in the individual financial statements of Alpha is made up as follows:

	$'000
Investment in Beta (Note 2)	236,500
Investment in Gamma (Note 3)	121,200
Other equity investments (Note 4)	13,000
	370,700

Note 2 – Alpha's investment in Beta

On 1 October 2012, Alpha acquired 90 million shares in Beta by means of a share exchange of two shares in Alpha for every three shares acquired in Beta. On 1 October 2012, the market value of an Alpha share was $3·90. Alpha incurred directly attributable costs of $2·5 million on acquisition of Beta relating to the cost of issuing its own shares.

On 1 October 2012, the individual financial statements of Beta showed retained earnings of $60 million.

DipIFR 17 Dec Questions

The directors of Alpha carried out a fair value exercise to measure the identifiable assets and liabilities of Beta at 1 October 2012. The following matters emerged:

– Property which had a carrying amount of $150 million (land component $45 million) had an estimated fair value of $210 million (land component $66 million). The buildings component of the property had an estimated remaining useful life of 30 years at 1 October 2012.

– Plant and equipment which had a carrying amount of $122 million had an estimated fair value of $145 million. The estimated remaining useful life of the plant at 1 October 2012 was four years.

– On 1 October 2012, the directors of Alpha identified a brand name relating to Beta which had a fair value of $25 million. This brand name was not recognised in the individual financial statements of Beta as it was internally developed. The directors of Alpha considered that the useful life of the brand name was 25 years from 1 October 2012.

– 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 calculating deferred tax. The rate of deferred tax to apply to temporary differences is 20%.

No impairment of the goodwill on acquisition of Beta has been evident since 1 October 2012. On 1 October 2012, the directors of Alpha initially measured the non-controlling interest in Beta at its fair value on that date. On 1 October 2012, the fair value of an equity share in Beta (which can be used to measure the fair value of the non-controlling interest) was $2·35.

Note 3 – Alpha's investment in Gamma

On 1 October 2016, Alpha acquired 80 million shares in Gamma by means of a cash payment of $120 million. Alpha incurred due diligence costs of $1·2 million associated with this purchase. The purchase agreement provided for an additional cash payment of $56 million to the former holders of the 80 million acquired shares on 1 October 2018. An appropriate annual discount rate to use in any relevant discounting to measure the fair value of this additional cash payment is 8%.

On 1 October 2016, the individual financial statements of Gamma showed retained earnings of $50 million.

On 1 October 2016, the fair values of the net assets of Gamma were the same as their carrying amount with the exception of some inventory which was recognised in the individual financial statements of Gamma at a cost of $12 million. The directors of Alpha considered that this inventory had a fair value of $15 million on 1 October 2016. This inventory was all sold by Gamma prior to 30 September 2017. The fair value adjustment was not reflected in the individual financial statements of Gamma. In the consolidated financial statements, the fair value adjustment will be regarded as a temporary difference for the purposes of calculating deferred tax. The rate of deferred tax to apply to temporary differences is 20%.

No impairment of the goodwill on acquisition of Gamma has been evident since 1 October 2016. On 1 October 2016, the directors of Alpha initially measured the non-controlling interest in Gamma at its fair value on that date. On 1 October 2016, the fair value of an equity share in Gamma was $1·75.

Note 4 – Other equity investments by Alpha

Alpha has a portfolio of equity investments which are classified in accordance with IFRS 9 – *Financial Instruments* – as 'fair value through profit or loss'. The carrying amount included in the financial statements of Alpha represents the fair value of the portfolio at 1 October 2016, which has been correctly adjusted for purchases and disposals in the year. The fair value of the portfolio at 30 September 2017 was $13·8 million.

Note 5 – Trade receivables and payables

On 29 September 2017, Gamma made a payment of $8 million to Beta to eliminate the intra-group balances at that date. This payment was received and recorded by Beta on 2 October 2017.

Note 6 – Share-based payment

On 1 October 2015, Alpha granted 200 senior managers options to buy 100,000 shares each between 30 September 2018 and 31 December 2018. The options are due to vest on 30 September 2018 provided the relevant managers remain employed over the three-year vesting period ending on that date. Since 1 October 2015 the expectation of the number of managers for whom the options would vest has varied as follows:

Date	Expected number of managers for whom the options will vest
1 October 2015	200
30 September 2016	180
30 September 2017	190

In preparing the financial statements of Alpha for the year ended 30 September 2016, the directors of Alpha debited retained earnings and credited other components of equity with the appropriate amount required by IFRS 2 – *Share-based payment*. The directors of Alpha have made no additional accounting entries in respect of the options in the draft financial statements for the year ended 30 September 2017.

On 1 October 2015, the fair value of one option was estimated to be $1·20. The fair value of the same option at 30 September 2016 and 2017 was estimated to be $1·25 and $1·30 respectively.

Note 7 – Long-term borrowing

On 1 October 2016, Alpha issued 60 million $1 loan notes at par. The annual rate of interest (payable in arrears) on the loan notes is 6%. The loan notes are repayable at par on 30 September 2026. As an alternative to repayment, the holders of the loan notes can elect to convert their loan notes into equity shares of Alpha on 30 September 2026. Had the conversion option not been available, the investors in the loan notes would have required an annual return of 9%.

Discount factors which may be relevant at 6% and 9% are as follows:

Discount rate	Present value of $1 receivable in 10 years	Present value of $1 receivable at the end of years 1–10
6%	55·8 cents	$7·36
9%	42·2 cents	$6·42

In preparing the draft financial statements for the year ended 30 September 2017, the directors of Alpha credited $60 million to long-term borrowings and showed the interest paid to the investors as a finance cost.

Required:

Prepare the consolidated statement of financial position of Alpha at 30 September 2017. You need only consider the deferred tax implications of any adjustments you make where the question specifically refers to deferred tax.

(40 marks)

DipIFR 17 Dec Questions

2 Delta prepares its financial statements to 30 September each year. The financial statements for the year ended 30 September 2017 are shortly to be authorised for issue. The following events are relevant to these financial statements:

(a) Delta operates a defined benefit retirement benefits plan on behalf of current and former employees. Delta receives advice from actuaries regarding contribution levels and overall liabilities of the plan to pay benefits. On 1 October 2016, the actuaries advised that the present value of the defined benefit obligation was $60 million. On the same date, the fair value of the assets of the defined benefit plan was $52 million. On 1 October 2016, the annual market yield on high quality corporate bonds was 5%.

During the year ended 30 September 2017, Delta made contributions of $7 million into the plan and the plan paid out benefits of $4·2 million to retired members. You can assume that both these payments were made on 30 September 2017.

The actuaries advised that the current service cost for the year ended 30 September 2017 was $6·2 million. On 31 August 2017, the rules of the plan were amended with retrospective effect. These amendments meant that the present value of the defined benefit obligation was increased by $1·5 million from that date.

During the year ended 30 September 2017, Delta was in negotiation with employee representatives regarding planned redundancies. The negotiations were completed shortly before the year end and redundancy packages were agreed. The impact of these redundancies was to reduce the present value of the defined benefit obligation by $8 million. Before 30 September 2017, Delta made payments of $7·5 million to the employees affected by the redundancies in compensation for the curtailment of their benefits. These payments were made out of the assets of the retirement benefits plan.

On 30 September 2017, the actuaries advised that the present value of the defined benefit obligation was $68 million. On the same date, the fair value of the assets of the defined benefit plan were $56 million.

(11 marks)

(b) On 1 April 2017, Delta completed the construction of a power generating facility. The total construction cost was $20 million. The facility was capable of being used from 1 April 2017 but Delta did not bring the facility into use until 1 July 2017. The estimated useful life of the facility at 1 April 2017 was 40 years.

Under legal regulations in the jurisdiction in which Delta operates, there are no requirements to restore the land on which power generating facilities stand to its original state at the end of the useful life of the facility. However, Delta has a reputation for conducting its business in an environmentally friendly way and has previously chosen to restore similar land even in the absence of such legal requirements. The directors of Delta estimated that the cost of restoring the land in 40 years' time (based on prices prevailing at that time) would be $10 million. A relevant annual discount rate to use in any discounting calculations is 5%. When the annual discount rate is 5%, the present value of $1 receivable in 40 years' time is approximately 14·2 cents. (9 marks)

Required:

Explain and show how the two events would be reported in the financial statements of Delta for the year ended 30 September 2017. When considering the reporting of events in the statement of comprehensive income, you should distinguish between events being reported in profit or loss from events being reported in other comprehensive income, where this is relevant. However, you do not need to comment on potential future reclassification issues.

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

(20 marks)

DipIFR 17 Dec Questions

3 IFRS 16 – *Leases* – was issued in January 2016 and applies to accounting periods beginning on or after 1 January 2019. However, earlier application is permitted. IFRS 16 replaces IAS 17 – *Leases*. IFRS 16 makes substantial changes to the requirements for the recognition of rights and obligations under leasing arrangements for lessees.

Required:

(a) Explain:

(i) Why the International Accounting Standards Board considered it necessary to make significant changes to the requirements for the recognition of rights and obligations under leasing arrangements in the financial statements of lessees. (4 marks)

(ii) How IFRS 16 requires lessees to recognise and measure rights and obligations under leasing arrangements. (4 marks)

(iii) Any exceptions to the usual requirements you have outlined in (ii) above. Your answer should briefly describe the accounting treatment required in the case of such exceptions and, where appropriate, the types of assets which these exceptions might apply to. (4 marks)

Kappa prepares financial statements to 30 September each year. On 1 October 2016, Kappa began to lease a property on a 10-year lease. The annual lease payments were $500,000, payable in arrears – the first payment being made on 30 September 2017. Kappa incurred initial direct costs of $60,000 in arranging this lease. The annual rate of interest implicit in the lease is 10%. When the annual discount rate is 10%, the present value of $1 payable at the end of years 1–10 is 6·145 dollars.

Required:

(b) Explain and show how these transactions would be reported in the financial statements of Kappa for the year ended 30 September 2017 under IFRS 16 – *Leases*. (8 marks)

(20 marks)

DipIFR 17 Dec Questions

4 You are the financial controller of Omega, a listed entity which prepares consolidated financial statements in accordance with International Financial Reporting Standards (IFRS). You have recently prepared the financial statements for the year ended 30 September 2017 and these are due to be published shortly. The managing director has reviewed these financial statements and has prepared a list of queries arising out of the review.

Query One

I'm confused about our treatment of equity investments in listed entities that we don't control. There seem to be two different treatments in our financial statements. One of the notes to the financial statements says that the equity investments we hold to temporarily invest surplus cash balances are measured at fair value and that changes in fair value are recognised in profit or loss. Another note says that the equity investment we hold in a key supplier is measured at fair value and that changes in fair value are recognised in other comprehensive income (OCI). Earnings per share (EPS) is a key performance indicator for Omega, so please explain how it can be justified to use two different treatments for equity investments made by the same entity. Please also explain what the impact on EPS might be if a gain or loss is reported in OCI rather than profit or loss. (6 marks)

Query Two

I noticed that OCI includes a gain of $64 million relating to the revaluation of our portfolio of properties. I looked in the notes to check that a corresponding amount of $64 million had been added to property, plant and equipment. However, the note explaining movements in property, plant and equipment showed a revaluation increase of $80 million. There was a reference to tax in one of the notes I looked at but I don't see why this is relevant. I know our rate of tax is 20% and this would explain the difference but we won't pay any tax on this gain unless we sell the properties. We have no intention of selling any of them in the foreseeable future, so what relevance does tax have? Please explain the difference between the $64 million gain in OCI and the $80 million gain added to property, plant and equipment. (6 marks)

Query Three

I'm aware that on 31 December 2016 we acquired a new subsidiary and therefore its results and net assets are included in our consolidated financial statements for the year ended 30 September 2017. I seem to recall from the discussions we held at the time that the year end of this subsidiary is 31 May rather than 30 September. How do we deal with the fact that the year ends are different when we prepare the consolidated financial statements? Do we have to prepare additional special information for this subsidiary when we consolidate? (4 marks)

Query Four

As you know, my son owns a business that supplies us with a very small proportion of the components that we use in our production process. This business is one of a number that supply us with these components and the overall quantity is totally insignificant to us. I was very surprised to see that details of these transactions with my son's business have been disclosed in the notes to the draft financial statements. This seems ridiculous when transactions with far more significant suppliers are not disclosed at all. Please explain the rationale of this disclosure to me. (4 marks)

Required:

Provide answers to the queries raised by the managing director. You should justify your answers with reference to relevant International Financial Reporting Standards.

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

(20 marks)

End of Question Paper

DipIFR

Diploma in International Financial Reporting

Friday 9 June 2017

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.

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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 2017 were as follows:

Statements of profit or loss and other comprehensive income

	Alpha $'000	Beta $'000	Gamma $'000
Revenue (Note 3)	468,000	260,000	240,000
Cost of sales (Notes 1-3)	(312,000)	(135,000)	(120,000)
Gross profit	156,000	125,000	120,000
Distribution costs	(26,000)	(20,000)	(18,000)
Administrative expenses (Note 4)	(44,000)	(28,000)	(27,000)
Investment income (Note 5)	28,000	Nil	Nil
Finance costs	(20,000)	(22,000)	(21,000)
Profit before tax	94,000	55,000	54,000
Income tax expense	(24,000)	(14,000)	(13,500)
Profit for the year	70,000	41,000	40,500
Other comprehensive income:			
Items that will be reclassified to profit or loss			
Gains/(losses) on effective cash-flow hedges (Note 6)	Nil	Nil	Nil
Total comprehensive income	70,000	41,000	40,500

Summarised statements of changes in equity

	Alpha	Beta	Gamma
Balance on 1 April 2016	250,000	193,000	166,500
Comprehensive income for the year	70,000	41,000	40,500
Dividends paid on 31 December 2016	(40,000)	(18,000)	(16,000)
Balance on 31 March 2017	280,000	216,000	191,000

Note 1 – Alpha's investment in Beta

On 1 April 2001, Alpha acquired 80 million of the 100 million $1 equity shares of Beta and gained control of Beta. Alpha paid $150 million in cash for these shares.

On 1 April 2001, the net assets of Beta had a fair value of $147 million, all of which had been disposed of or settled by 31 March 2016.

Alpha used the fair value method for measuring the non-controlling interest when recognising the goodwill on acquisition of Beta. The fair value of an equity share in Beta on 1 April 2001, which was $1·50, was used for this purpose. No impairments of goodwill on acquisition of Beta have been necessary in the consolidated financial statements of Alpha up to and including 31 March 2016.

Beta has three cash generating units. On 31 March 2017, the annual impairment review indicated that the recoverable amounts of the net assets, including goodwill, of the three cash generating units of Beta at that date were as follows:

- Unit 1 – $87 million.
- Unit 2 – $84 million.
- Unit 3 – $80 million.

Net assets and goodwill are allocated equally to the three units and any impairments of goodwill should be charged to cost of sales.

DipIFR 17 June Questions

Note 2 – Alpha's investment in Gamma

On 1 August 2016, Alpha acquired 60 million of the 80 million \$1 equity shares in Gamma and gained control of Gamma. The acquisition was financed as follows:

– Alpha issued two new shares to the former shareholders of Gamma for every three shares Alpha acquired in Gamma. On 1 August 2016, the fair value of an equity share in Alpha was \$4·50.

– Alpha agreed to pay a total of \$16·2 million in cash to the former shareholders of Gamma on 31 July 2017. Alpha's incremental borrowing rate at 1 August 2016 was 8% per annum.

– Alpha agreed to issue additional shares in Alpha to the former shareholders of Gamma on 30 September 2019 if the cumulative profits of Gamma for the three-year period from 1 August 2016 to 31 July 2019 exceed a target amount. On 1 August 2016, the fair value of this contingent equity consideration was \$26 million.

Alpha has not yet accounted for this acquisition in its individual financial statements. However, you can assume that no impairment of the goodwill on acquisition of Gamma is necessary in the consolidated financial statements of Alpha for the year ended 31 March 2017. Alpha has resolved to use the proportion of net assets method for measuring the non-controlling interest when recognising the goodwill on the acquisition of Gamma.

On 1 August 2016, the fair values of the net assets of Gamma were the same as their carrying amounts in the financial statements of Gamma with the exception of:

– Land – whose fair value exceeded the carrying amount by \$30 million.

– Plant and equipment – whose fair value exceeded the carrying amount by \$12 million. The estimated remaining useful life of the plant and equipment of Gamma at 1 August 2016 was five years.

All depreciation of property, plant and equipment is charged to cost of sales. You can assume that the profit of Gamma for the year ended 31 March 2017 accrued evenly over the year.

Note 3 – Intra-group trading

Alpha supplies a component used by both Beta and Gamma. Alpha earns a profit margin of 20% on these supplies. Details of the sales of the component, and the holdings of inventory of the component by group entities, are as follows:

	Beta \$'000	Gamma \$'000
Sales of the component (for Gamma all sales since 1 August 2016)	20,000	10,000
Inventory of component at 31 March 2016 (at cost to Beta/Gamma)	4,000	Nil
Inventory of component at 31 March 2017 (at cost to Beta/Gamma)	6,000	4,800

Note 4 – Decommissioning provision

On 1 April 2016, Alpha completed the construction of an energy generating facility and brought the facility into use immediately. The cost of construction of the facility was included in property, plant and equipment and was also appropriately depreciated over the useful life of the facility, which was estimated at 16 years at 1 April 2016. At the end of the useful life of the facility, Alpha has an obligation to decommission the facility and restore its location to its former condition. The estimated cost of this decommissioning and restoration is \$8 million, payable on 31 March 2032. The directors of Alpha made a provision of \$8 million in respect of this liability, and charged \$8 million to administrative expenses in the year ended 31 March 2017. An appropriate discount rate to use in any discounting calculations is 8% per annum. At 1 April 2016, the present value of \$1 payable in 16 years' time at 8% can be taken as 30 cents.

Note 5 – Investment income

The investment income which is shown in Alpha's statement of profit or loss represents dividends received from Beta and Gamma and also dividends received from a portfolio of other equity investments. This portfolio is classified by Alpha as fair value through profit or loss. The gain on remeasurement of the portfolio to fair value at 31 March 2017 was \$6·5 million. This gain has not yet been recognised in the financial statements of Alpha.

Note 6 – Cash flow hedge

On 1 January 2017, Alpha agreed to purchase goods from a foreign supplier. This purchase is due to be made and paid for on 30 June 2017. The directors of Alpha decided to hedge the cash-flow risk attaching to this future purchase by entering into a derivative contract and to formally designate the derivative as a hedging instrument. The hedge met all of the effectiveness requirements for the use of hedge accounting. On 31 March 2017, the derivative had a positive fair value resulting in a gain to Alpha of $5 million. Between 1 January 2017 and 31 March 2017 the expected cash flows in respect of the purchase of goods on 30 June 2017 had increased by $4·2 million. Alpha has not made any accounting entries in respect of this arrangement.

Required:

(a) Using the information in notes 1 and 2, compute the goodwill arising on the acquisitions of Beta and Gamma in the consolidated financial statements of Alpha. (7 marks)

(b) Prepare the consolidated statement of profit or loss and other comprehensive income of Alpha for the year ended at 31 March 2017. You do not need to consider the tax effects of any adjustments you make. (26 marks)

(c) Prepare the summarised consolidated statement of changes in equity of Alpha for the year ended 31 March 2017, including a column for the non-controlling interest. (7 marks)

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. Each year, the financial statements are authorised for issue on 25 May. The following events have occurred which are relevant to the year ended 31 March 2017:

Event (a)

On 1 April 2016, Delta purchased an asset for $771,000 and immediately leased this asset to entity X. The lease term was for five years and the lease rental, receivable annually in arrears on 31 March, was $200,000. Delta incurred direct costs of $20,000 in arranging this lease. The annual rate of interest implicit in this lease was 10%. Under the terms of the lease, entity X is responsible for insuring the asset and for carrying out any necessary repairs and maintenance of the asset. At a discount rate of 10% per annum the present value of $1 receivable annually in arrears for five years is $3·80. (8 marks)

Event (b)

On 1 April 2016, Delta entered into a joint arrangement with entity Y to jointly operate a delivery depot. Entity Y is located, and has major customers in, the same geographical region as Delta. Delta and entity Y each made the following payments in respect of the arrangement on 1 April 2016:

- $25 million each to purchase a joint 25-year leasehold interest in a depot which was close to both Delta and entity Y's business premises. This depot was to act as headquarters for the delivery vehicles (see below).
- $7·5 million each to purchase a fleet of delivery vehicles. The vehicles have an expected useful life of five years, with no expected residual value.

Delta and entity Y agreed to jointly use the delivery vehicles to deliver products to their customers, and to share the operating costs of the depot equally. Any delivery charges to customers were levied by Delta and entity Y directly at the discretion of the individual entities. During the year ended 31 March 2017, the total cash cost of operating the depot was $8 million. This was paid equally by Delta and entity Y. In the year ended 31 March 2017, Delta charged its customers a total of $2 million in delivery charges. (7 marks)

Event (c)

On 31 March 2017, Delta was owed $10m by entity Z. The amount was due for payment by 30 April 2017. Entity Z has been a customer for many years and has an excellent payment record. At 31 March 2017, there was no reason to suppose that entity Z would fail to pay the $10m owed to Delta by 30 April 2017. By 20 April 2017, entity Z's going concern status was in considerable doubt. (5 marks)

Required:

Explain and state (where possible by quantifying amounts) how the three events would be reported in the financial statements of Delta for the year ended 31 March 2017.

Note: The mark allocation is shown against each of the three events above. You should assume that all amounts described here are material.

(20 marks)

3 **(a)** Non-current assets are often a highly significant component of the total assets of an entity. Therefore, a number of different International Financial Reporting Standards have been published which regulate their definition, recognition, measurement and disclosure. IAS 1 *Presentation of Financial Statements* distinguishes between current and non-current assets. IAS 16 *Property, Plant and Equipment* and IAS 38 *Intangible Assets* specifically regulate the recognition, measurement and disclosure of tangible and intangible assets respectively.

Required:

Explain how:

(i) **IAS 1 distinguishes between current and non-current assets.** (3 marks)

(ii) **IAS 16 defines property, plant and equipment and IAS 38 defines intangible assets.** (4 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 2017:

(i) On 1 April 2016, Epsilon purchased a new head office property for $60 million. On 1 April 2016, Epsilon leased out the top three floors of the property to a third party on a long-term operating lease. The annual rental receivable by Epsilon was $2 million, starting on 31 March 2017. The top three floors of the property were capable of being sold in a separate transaction. On 1 April 2016, the directors of Epsilon estimated that the initial cost of the property should be allocated as follows for accounting purposes:

	$ million
Top three floors of building	15
Remainder – buildings component	20
Remainder – land component	25
Total initial cost	60

On 31 March 2017, the property had an estimated total fair value of $64 million. The directors consider that 25% of this fair value was attributable to the top three floors of the property. The directors of Epsilon wish to use the cost model for measuring property, plant and equipment and the fair value model for measuring investment property. Epsilon depreciates the buildings component of properties over an estimated useful life of 50 years, with no estimated residual value. The rental payable to Epsilon on 31 March 2017 was paid in accordance with the terms of the lease. (8 marks)

(ii) On 1 April 2016, Epsilon purchased a brand from a competitor for an agreed price of $80 million. The directors of Epsilon believe that the useful life of the brand is indefinite. On 31 March 2017, no reliable estimate of its selling price was available but the directors of Epsilon estimated that the value in use of the brand was $85 million. The directors of Epsilon wish to use the fair value model for measuring intangible assets whenever permitted by International Financial Reporting Standards. (5 marks)

Required:

Explain and state how the two events should be reported in the financial statements of Epsilon for the year ended 31 March 2017.

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

(20 marks)

DipIFR 17 June Questions

4 You are the financial controller of Omega, a listed entity which prepares consolidated financial statements in accordance with International Financial Reporting Standards (IFRS). One of your assistants, a trainee accountant, is involved in the preparation of the consolidated financial statements for the year ended 31 March 2017. She is also involved in the preparation of the individual financial statements for the entities in the group. She has sent you an email with the following queries:

Query One

On 1 April 2016 we acquired a new subsidiary. This subsidiary has always prepared its financial statements in $ but has used IFRS for the first time this year. Previously, they have used local standards. This means that the comparative figures (they present comparatives for one year only), taken from last year's financial statements, will be based on local standards not IFRS. How do I make sure we are comparing like with like in the current year individual financial statements of the subsidiary? Please just give me the general procedure, rather than dealing with any specialised exemptions. (7 marks)

Query Two

I notice that on 1 April 2016 we lent $50 million to a key supplier. The loan has an annual rate of interest of 5%, with interest of $2·5 million payable on 31 March each year in arrears. The loan is repayable on 31 March 2026 but I believe that if interest rates change, we might consider assigning the loan to a third party. As it turns out, interest rates have fallen since 1 April 2016 and the fair value of the loan asset at 31 March 2017 was $52 million. I have been told that this loan asset should be measured at 'fair value through other comprehensive income'. Why is this? I thought loan assets were measured at amortised cost. If the loan asset is measured at fair value through other comprehensive income, does the interest income get recorded in other comprehensive income rather than profit or loss? (6 marks)

Query Three

I'm not sure whether we need to make any entries in respect of the equity settled share-based payment scheme we started on 1 April 2016. I believe we granted options to 1,000 employees to purchase 100 shares in Omega for a fixed price. The options vest on 31 March 2021 subject to two conditions. The first vesting condition is that the employees remain employed by Omega throughout the five-year period up to the date of vesting. Best estimates are that 900 of the 1,000 will stay for that period – only 25 left in the year ended 31 March 2017. The other condition is that the Omega share price on 31 March 2021 should be at least $10. The share price on 31 March 2017 was only $8·50 so it doesn't look like this condition is satisfied yet. I've also noticed that the fair value of one share option was $1 on 1 April 2016, rising to $1·05 on 31 March 2017. Do we need any accounting entries and, if so, what should they be? (7 marks)

Required:

Provide answers to the three queries raised by the trainee accountant. Your answers should refer to relevant provisions of International Financial Reporting Standards.

Note: The split of the mark allocation is shown against each of the items above.

(20 marks)

End of Question Paper

DipIFR 17 June Questions