Diploma in International Financial Reporting (Dip IFR)

Friday 5 June 2020

IFR INT ACCA EN

Time allowed: 3 hours 15 minutes

ALL FOUR questions are compulsory and MUST be attempted.

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

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

Dip IFR

Think Ahead ACCA

The Association of Chartered Certified Accountants

ALL FOUR questions are compulsory and MUST be attempted

1 Alpha, a parent company with one subsidiary, Beta, is preparing the consolidated statement of profit or loss and other comprehensive income for the year ending 31 March 20X5. The draft statements of profit or loss and other comprehensive income are as follows:

	Alpha	Beta
	$'000	$'000
Revenue (Note 2)	64,800	39,000
Cost of sales (Notes 2 and 4)	(26,000)	(16,000)
Gross profit	38,800	23,000
Distribution costs	(5,000)	(2,000)
Administrative expenses	(9,000)	(3,500)
Investment income (Notes 1 and 3)	7,000	0
Finance costs (Note 1)	(4,000)	(2,500)
Profit before tax	27,800	15,000
Income tax expense	(7,000)	(4,000)
Profit for the year	20,800	11,000
Other comprehensive income:		
Items that will not be reclassified to profit or loss:		
Gains on property revaluation (Note 4)	5,000	3,000
Other comprehensive income for the year:	5,000	3,000
Total comprehensive income for the year	25,800	14,000

Note 1 – Alpha's investment in Beta

On 1 April 20X3, Alpha acquired 180 million equity shares in Beta. On that date Beta had 200 million equity shares in issue. Alpha made a cash payment of $60 million to the former shareholders of Beta on 1 April 20X3 and agreed to make a further payment of $26·62 million on 31 March 20X6.

Alpha had correctly accounted for the deferred payment in its financial statements for the year ended 31 March 20X4 but has made no further entries in its financial statements for the year ended 31 March 20X5. An appropriate annual rate to use in any discounting calculations is 10%. At a discount rate of 10% per annum the present value of $1 payable in three years is $0·7513.

On 31 December 20X4, Beta paid a dividend of $5 million. This was the only dividend paid by Beta in the year ended 31 March 20X5 and was appropriately recognised by Alpha.

On 1 April 20X3, Alpha made a long-term loan to Beta of $25 million. The loans are included in the financial statements of Beta at this amount. These long-term loans attract interest at an annual rate of 8%. Both Alpha and Beta have correctly accounted for this interest in their individual financial statements for the year ended 31 March 20X5.

No impairments of the goodwill on acquisition of Beta have been evident up to and including 31 March 20X5.

Note 2 – Intra-group trading

Alpha supplies Beta with a raw material which it uses in its production process. Alpha applies a mark-up of one-third to its cost. Sales of the raw material by Alpha to Beta in the year ended 31 March 20X5 totalled $10 million. On 31 March 20X4 and 20X5, the inventories of Beta included goods costing $2 million and $3 million respectively which had been purchased from Alpha.

Note 3 – Alpha's other investments

Apart from its investments in the equity shares and loans of Beta, Alpha has a portfolio of equity investments which are correctly classified as fair value through profit or loss. The investment income of Alpha for the year ended 31 March 20X5 currently correctly includes dividend income from this portfolio. However, the carrying amount of the portfolio has not yet been adjusted to its fair value at 31 March 20X5. On 31 March 20X5, the carrying amount of the portfolio was $32 million and its fair value $33·5 million.

Note 4 – Revaluation of property, plant and equipment (PPE)

Both Alpha and Beta measure their PPE using the revaluation model. PPE is re-measured at the end of each financial year.

In previous periods Alpha had recorded net revaluation losses of $3·5 million. These losses were correctly accounted for under the requirements of IAS® 16 – *Property, Plant and Equipment*.

In the financial statements of Alpha for the year ended 31 March 20X5, re-measurement gains of $5 million were entirely recognised in other comprehensive income. These gains related to the same properties which had previously suffered revaluation losses.

Beta has only ever recorded revaluation gains. All depreciation and impairments of PPE are recognised in cost of sales.

Note 5 – Equity settled share based payment scheme

On 1 April 20X3, Alpha granted 500 senior executives 4,000 share options each. The options vest on 31 March 20X7. The options only vest for senior executives who remain employed by Alpha on 31 March 20X7. The following information is relevant:

Date	Fair value of option ($)	Number of executives for whom the option is expected to vest
1 April 20X3	1·20	400
31 March 20X4	1·35	420
31 March 20X5	1·50	450

This transaction was correctly accounted for in the financial statements of Alpha for the year ended 31 March 20X4 and the cost was recognised as an administrative expense. However, no further entries have yet been made in the financial statements for the year ended 31 March 20X5.

Required:

Prepare the consolidated statement of profit or loss and other comprehensive income of Alpha for the year ended 31 March 20X5. Where relevant you should round all figures to the nearest $'000.

Note: Ignore deferred tax.

(25 marks)

2 Gamma prepares consolidated financial statements to 31 March each year. Notes 1 and 2 contain information relevant to these financial statements:

Note 1 – Impairment of goodwill

On 1 April 20X3, Gamma purchased 75% of the equity shares of subsidiary X for a cash payment of $99 million. The fair value of the net assets of subsidiary X on that date was $108 million. Gamma measured the non-controlling interest in subsidiary X using the proportionate method. On 31 March 20X4, Gamma reviewed the goodwill on acquisition of subsidiary X for impairment but no impairment was evident.

On 31 March 20X5, the carrying amount of the net assets of subsidiary X in the consolidated financial statements of Gamma (excluding goodwill on acquisition) was $115 million. Subsidiary X is a single cash-generating unit for impairment purposes. On 31 March 20X5, the value in use of subsidiary X was $135 million and its fair value less costs of disposal was $130 million. (8 marks)

Note 2 – Purchase of machine

On 1 January 20X4, Gamma entered into a firm commitment to purchase a machine from a supplier whose functional currency is the kroner. This firm commitment was not an onerous contract. The cost of the machine was 14·4 million kroner and the agreed delivery date was 30 June 20X4. Gamma was due to pay 14·4 million kroner to the supplier on 31 July 20X4.

On 1 January 20X4, Gamma entered into a forward exchange contract with a bank to purchase 14·4 million kroner for $1·44 million on 31 July 20X4. The forward exchange contract was entered into so as to provide a hedge against the currency risk associated with the firm commitment to purchase the machine.

On 30 June 20X4, Gamma took delivery of the machine and immediately brought the machine into use. Gamma estimated that the machine would have a useful life of five years from 30 June 20X4, with no residual value.

On 31 July 20X4, Gamma paid 14·4 million kroner to the supplier of the machine and received payment of $360,000 from the bank in settlement of the forward exchange contract (see below).

Gamma designated the forward exchange contract as a hedge of the cash flows expected to arise on the purchase of the machine. This contract was a perfectly effective hedge of those cash flows. Gamma wishes to use hedge accounting to reflect the above transactions in its financial statements.

Relevant exchange rates and fair values of the forward exchange contract are as follows:

Date	Exchange rate (kroners to $1)	Fair value of forward contract (favourable to Gamma) $'000	
1 January 20X4	10	Nil	
31 March 20X4	9·6	60	
30 June 20X4	9	160	
31 July 20X4	8	360	(17 marks)

Required:

Using the information in notes 1 and 2, explain and show how the two events would be reported in the consolidated financial statements of Gamma for the year ended 31 March 20X5.

Note: The mark allocations are indicated in each note above. Marks will be awarded for explanations as well as for computations.

(25 marks)

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Question 3 begins on page 6.

3 Delta prepares financial statements to 31 March each year. Delta applies IAS 12 – *Income Taxes* – and IAS 41 – *Agriculture* – in the preparation of its financial statements.

IAS 12 requires that entities recognise deferred tax liabilities on taxable temporary differences and, in certain circumstances, deferred tax assets on deductible temporary differences. Temporary differences are determined by comparing the carrying amount of an asset or liability with its tax base.

IAS 41 sets out the principles of recognition and measurement for biological assets and harvested produce.

Note 1 – Temporary differences

On 1 October 20X4, Delta purchased an item of plant for $4 million. The estimated useful life of the plant was five years, with no residual value. Under tax legislation in the country in which Delta is located, purchases of plant attract a tax deduction of 50% of the cost in the accounting period in which the plant is purchased and 25% of the cost in each of the following two accounting periods.

On 1 July 20X4, Delta borrowed $20 million from a bank. The loan attracts interest at a rate of 8% per annum on the $20 million borrowed. The interest is payable annually in arrears. The loan is repayable on 30 June 20X9. Under tax legislation in the country in which Delta is located, a tax deduction for the interest on loans is available in the accounting periods in which the interest is actually paid.

On 1 April 20X4, Delta purchased some land for $15 million. Delta uses the revaluation model to measure land in its financial statements. On 31 March 20X5, Delta estimated that the value of the land was $18 million and this amount was recognised in Delta's financial statements. Under tax legislation in the country in which Delta is located, gains on the value of land are not taxable unless or until the land is sold. Delta has no intention of disposing of this land in the foreseeable future.

The rate of corporate income tax in the country in which Delta is located is 20% per annum.

The directors of Delta anticipate that Delta will make taxable profits for the foreseeable future. Delta had no temporary differences at 31 March 20X4. (12 marks)

Note 2 – Agricultural activity

Delta is a farming entity specialising in milk production. Cows are milked on a daily basis. Milk is kept in cold storage immediately after milking and sold to retail distributors on a weekly basis.

On 1 April 20X4, Delta had a herd of 500 cows which were all three years old.

During the year, some of the cows became sick and on 30 September 20X4 20 cows died. On 1 October 20X4, Delta purchased 20 replacement cows at the market for $210 each. These 20 cows were all one year old when they were purchased.

On 31 March 20X5, Delta had 1,000 litres of milk in cold storage which had not been sold to retail distributors. The market price of milk at 31 March 20X5 was $2 per litre. When selling the milk to distributors, Delta incurs selling costs of 10 cents per litre. These amounts did not change during March 20X5 and are not expected to change during April 20X5.

Information relating to fair value and costs to sell is given below:

Date	**Fair value of a dairy cow which is:**				**Costs to sell a cow at market**
	1 year old	**1½ years old**	**3 years old**	**4 years old**	
	$	$	$	$	$
1 April 20X4	200	220	270	250	10
1 October 20X4	210	230	280	260	10
31 March 20X5	215	235	290	265	11

(13 marks)

Required:

Using the information in notes 1 and 2, explain, with appropriate computations, how Delta should report these transactions in the financial statements for the year ended 31 March 20X5.

Note: The mark allocations are indicated in each note above. Marks will be awarded for explanations as well as for computations.

(25 marks)

4 Omega is a listed entity and you are the financial controller. The financial statements of Omega for the year ended 31 March 20X5 are currently being prepared. One of Omega's directors has sent you three questions regarding the financial statements.

Question 1 – Right-of-use asset

When I looked at the note which gave details of our property, plant and equipment, a separate component appeared for the first time this year. This component was described as a right-of-use asset. Upon further investigation, I discovered that this related to a warehouse which we started to lease on 1 October 20X4 to provide us with more capacity. The warehouse is being leased on a five-year lease contract at an annual rental of $500,000, payable in arrears. There is no option to extend the lease at the end of the five-year period. Based on current annual interest rates (10%), these rentals have a total present value of $1,895,000.

We incurred direct costs of $105,000 when arranging this lease with the owner. The carrying amount of the right-of-use asset which is shown in the financial statements is $1·8 million. I don't understand this at all. In particular, I have three questions about this that I would like you to answer:

– The warehouse would cost at least $10 million to purchase outright and has a useful life of around 25 years. How can it be presented as Omega's asset in these circumstances?

– Where does the figure of $1·8 million come from?

– Apart from the right-of-use asset, how else will this transaction affect our financial statements? I don't need detailed workings here, just explanations. (11 marks)

Question 2 – Segment reporting

I know that, because we're a listed entity, we are required to disclose details of the financial performance and financial position of different business segments in the notes to our financial statements. I thought it would be interesting to compare the segment report in our financial statements with that of a key competitor. When I did this, I found myself very confused. Our segment report was based on the performance and position by geographical area whereas our competitor's report was based on the performance and position by product type.

How can this be correct when both of us are preparing our financial statements in accordance with International Financial Reporting Standards (IFRS® Standards) – is there not a definition of a 'segment' that would be applied to all businesses?

(8 marks)

Question 3 – Immaterial transactions

You may know that the contract for cleaning our Head Office has been given to a firm which is controlled by my brother. This contract was approved in the normal way and I was not involved in the approval process to avoid any perception of a conflict of interest as my brother and I are known to holiday and socialise together. The contract has normal commercial terms and is very insignificant in the context of Omega as an entity. I'm very surprised, therefore, to see details of this contract disclosed in our financial statements when many other much more financially significant contracts are not disclosed in the same detail. Surely this disclosure is unnecessary when the monetary amounts are so small and there is nothing 'out of the ordinary' about the contract? (6 marks)

Required:

Provide answers to the questions raised by one of Omega's directors relating to the financial statements for the year ended 31 March 20X5.

Note: The mark allocations are indicated in each question above.

(25 marks)

End of Question Paper