Answers

Section A

1 A

A change of classification in presentation in financial statements is a change of accounting policy (CAP) under IAS 8.

2 C

3 B

Historical cost annual depreciation = $90,000 ((500,000 x 90%)/5 years).
After two years carrying amount would be $320,000 (500,000 – (2 x 90,000)).
Current cost annual depreciation = $108,000 ((600,000 x 90%)/5 years).
After two years carrying amount would be $384,000 (600,000 – (2 x 108,000)).

4 C

Although the invoiced amount is $180,000, $30,000 of this has not yet been earned and must be deferred until the servicing work has been completed.

5 C

(i) is an onerous contract and (iii) the provision is still required if there is no intention to sell

6 B

The total profit on the contract is expected to be $1 million (5,000 – (1,600 + 2,400)).
At 30 September 2014 the profit recognised would be $360,000 (1,000 x 1,800/5,000).

Therefore the amount due from the customer would be:

	$'000
Cost to date	1,600
Profit recognised	360
Progress billings	(1,800)
Amount due from the customer	160

7 D

As the receivable is 'sold' with recourse it must remain as an asset on the statement of financial position; it is not derecognised.

8 D

The normal selling price of damaged inventory is $300,000 (210/70%).

This will now sell for $240,000 (300,000 x 80%), and have a NRV of $180,000 (240 – (240 x 25%)). The expected loss on the inventory is $30,000 (210 cost – 180 NRV) and therefore the inventory should be valued at $970,000 (1,000 – 30).

9 A

Cash flow is (in $ million):
23·4 – 14·4 b/f + 2·5 dep + 3 disposal – 2 revaluation – 4 non-cash acquisition = 8·5

10 D

The investment no longer meets the definition of a subsidiary (ability to control) and therefore would not be consolidated.

11 A

Year ended 30 September	Cash flow $'000	Discount rate at 8%	Discounted cash flows $'000
2014	500	0·93	465
2015	500	0·86	430
2016	10,500	0·79	8,295
Value of debt component			9,190
Difference – value of equity option component			810
Proceeds			10,000

12 A

Goodwill should be written off in full and the remaining loss is allocated pro rata to property plant and equipment and the product patent.

	B/f $	Loss $	Post loss $
Property, plant and equipment	200,000	(45,455)	154,545
Goodwill	50,000	(50,000)	nil
Product patent	20,000	(4,545)	15,455
Net current assets (at NRV)	30,000	nil	30,000
	300,000	(100,000)	200,000

13 B

Correct for the reason given in the question.

14 C

At 30 September 2014:
Carrying amount = $37·5 million (45,000 – 6,000 b/f – 1,500 for 6 months; no further depreciation when classified as held for sale).
Recoverable amount = $36·8 million ((42,000 x 90%) – 1,000).
Therefore included at $36·8 million (lower of carrying amount and fair value less cost to sell).

15 A

A not-for-profit entity is not likely to have shareholders or 'earnings'.

16 A

Is the correct treatment for a bargain purchase (negative goodwill).

17 B

Extraction provision at 30 September 2014 is $2·5 million (250 x 10).
Dismantling provision at 1 October 2013 is $20·4 million (30,000 x 0·68).
This will increase by an 8% finance cost by 30 September 2014 = $22,032,000.
Total provision is $24,532,000.

18 D

Although the estimated NRV is lower than it was (due to fire damage), the entity will still make a profit on the inventory and thus it is not an indicator of impairment.

19 C

Rental of excavation equipment $13,500 (18 x 9/12)
Depreciation of finance leased plant $68,000 (340/5 years)
Finance cost $25,000 ((340 – 90) x 10%)
Total $106,500

20 D

As it is a new type of transaction, comparability with existing treatments is not relevant.

Section B

1 (a) For comparison

	Hydan adjusted	**Hydan as reported**	**Sector average**
Return on equity (ROE)	21·7%	47·1%	22·0%
Net asset turnover	1·75 times	2·36 times	1·67 times
Gross profit margin	28·6%	35·7%	30·0%
Net profit margin	9·3%	20·0%	12·0%

Hydan's adjusted ratios:
On the assumption that after the purchase of Hydan, the favourable effects of the transactions with other companies owned by the family would not occur, the following adjustments to the statement of profit or loss should be made:

	$'000
Cost of sales (45,000/0·9)	50,000
Directors' remuneration	2,500
Loan interest (10% x 10,000)	1,000

These adjustments would give a revised statement of profit or loss:

Revenue	70,000
Cost of sales	(50,000)
Gross profit	20,000
Operating costs	(7,000)
Directors' remuneration	(2,500)
Loan interest	(1,000)
Profit before tax	9,500
Income tax expense	(3,000)
Profit for the year	6,500

In the statement of financial position:

Equity would be the purchase price of Hydan (per question)	30,000
The commercial loan (replacing the directors' loan) would now be debt	10,000

From these figures the adjusted ratios above are calculated as:

Return on equity	((6,500 /30,000) x 100)	21·7%
Net asset turnover	(70,000/(30,000 + 10,000))	1·75 times
Gross profit margin	((20,000)/70,000) x 100)	28·6%
Net profit margin	((6,500/70,000) x 100)	9·30%

(b) An analysis of Hydan's ratios based on the financial statements provided reveals a strong position, particularly in relation to profitability when compared to other businesses in this retail sector. Hydan has a very high ROE which is a product of higher-than-average profit margins (at both the gross and net profit level) and a significantly higher net asset turnover. Thus, on the face of it, Hydan is managing to achieve higher prices (or reduced cost of sales), has better control of overheads and is using its net assets more efficiently in terms of generating revenue.

However, when adjustments are made for the effects of its favourable transactions with other companies owned by the family, the position changes somewhat. The effect of purchasing its inventory from another family owned supplier at favourable market prices means that its reported gross profit percentage of 35·7% is flattered; had these purchases been made at market prices, it would fall to 28·6% which is below the sector average of 30·0%. The effects of the favourable inventory purchases carry through to net profit. Based on Xpand's estimate of future directors' remuneration, it would seem the existing directors of Hydan are not charging commercial rates for their remuneration. When Xpand replaces the board of Hydan, it will have to increase directors' remuneration by $1·5 million. Additionally, when the interest free directors' loans are replaced with a commercial loan, with interest at 10% per annum, this would reduce net profit by a further $1 million. The accumulation of these adjustments means that the ROE which Xpand should expect would be 21·7% (rather than the reported 47·1%) which is almost exactly in line with the sector average of 22·0%.

In a similar vein, when the asset turnover is calculated based on the equity purchase price and the commercial loan (equating to net assets), it falls from 2·36 times to 1·75 times which is above, but much closer to, the sector average of 1·67 times.

In summary, Hydan's adjusted results would still be slightly ahead of the sector averages in most areas and may well justify the anticipated purchase price of $30 million; however, Hydan will be nowhere near the excellently performing company suggested by the reported figures and Xpand needs to exercise a degree of caution in its negotiations.

2 (a) Kandy – Schedule of retained earnings of Kandy as at 30 September 2014

	$'000
Retained earnings per trial balance	17,500
Adjustments re:	
Note (i)	
Add back issue costs of loan note (w (i))	1,000
Loan finance costs (29,000 x 9% (w (i)))	(2,610)
Note (ii)	
Depreciation of buildings (w (ii))	(2,600)
Depreciation of plant and equipment (w (ii))	(3,000)
Note (iii)	
Income tax expense (w (iii))	(800)
Adjusted retained earnings	9,490

(b) Kandy – Statement of financial position as at 30 September 2014

Assets	**$'000**	**$'000**
Non-current assets		
Property, plant and equipment (44,400 + 21,000 (w (ii)))		65,400
Current assets (per trial balance)		68,700
Total assets		134,100
Equity and liabilities		
Equity		
Equity shares of $1 each		40,000
Revaluation surplus (12,000 – 2,400 (w (ii) and (iii)))	9,600	
Retained earnings (from (a))	9,490	19,090
		59,090
Non-current liabilities		
Deferred tax (w (iii))	4,400	
6% loan note (w (i))	29,810	34,210
Current liabilities		
Per trial balance	38,400	
Current tax payable	2,400	40,800
Total equity and liabilities		134,100

Workings (monetary figures in brackets in $'000)

(i) Loan note

The issue costs should be deducted from the proceeds of the loan note and not charged as an expense. The finance cost of the loan note, at the effective rate of 9% applied to the carrying amount of the loan note of $29 million (30,000 – 1,000), is $2,610,000. The interest actually paid is $1·8 million. The difference between these amounts of $810,000 (2,610 – 1,800) is added to the carrying amount of the loan note to give $29,810,000 (29,000 + 810) for inclusion as a non-current liability in the statement of financial position.

(ii) Non-current assets

Land and buildings
The gain on revaluation and carrying amount of the land and buildings will be:

	$'000
Carrying amount at 1 October 2013 (55,000 – 20,000)	35,000
Revaluation at that date (8,000 + 39,000)	47,000
Gain on revaluation	12,000
Buildings depreciation for the year ended 30 September 2014 (39,000/15 years)	(2,600)
Carrying amount at 30 September 2014 (47,000 – 2,600)	44,400

	$'000
Plant and equipment	
Carrying amount at 1 October 2013 (58,500 – 34,500)	24,000
Depreciation for year ended 30 September 2014 (12½% reducing balance)	(3,000)
Carrying amount at 30 September 2014	21,000

(iii) Taxation

Income tax expense	
Provision for year ended 30 September 2014	2,400
Less over-provision in previous year	(1,100)
Deferred tax (see below)	(500)
	800
Deferred tax	
Provision required at 30 September 2014 ((10,000 + 12,000) x 20%)	4,400
Provision at 1 October 2013	(2,500)
Movement in provision	1,900
Charge to revaluation of land and buildings (12,000 x 20%)	(2,400)
Balance – credit to profit or loss	(500)

3 (a) Plastik

Consolidated statement of profit or loss and other comprehensive income for the year ended 30 September 2014

	$'000
Revenue (62,600 + (30,000 x 9/12) – (300 x 9 months intra-group sales))	82,400
Cost of sales (w (i))	(61,320)
Gross profit	21,080
Distribution costs (2,000 + (1,200 x 9/12))	(2,900)
Administrative expenses (3,500 + (1,800 x 9/12) + 500 goodwill impairment)	(5,350)
Finance costs (200 + 135 (w (v)))	(335)
Profit before tax	12,495
Income tax expense (3,100 + (1,000 x 9/12))	(3,850)
Profit for the year	8,645
Other comprehensive income	
Gain on revaluation of property (1,500 + 600)	2,100
Total comprehensive income	10,745
Profit for year attributable to:	
Equity holders of the parent (balance)	8,465
Non-controlling interest (w (ii))	180
	8,645
Total comprehensive income attributable to:	
Equity holders of the parent (balance)	10,445
Non-controlling interest (180 above + (600 x 20%))	300
	10,745

(b) **Plastik – Consolidated statement of financial position as at 30 September 2014**

	$'000
Assets	
Non-current assets	
Property, plant and equipment (w (iii))	37,100
Intangible asset: goodwill (w (iv))	5,200
	42,300
Current assets	
Inventory (4,300 + 1,200 – 120 URP (w (i)))	5,380
Trade receivables (4,700 + 2,500 – 1,200 intra-group)	6,000
Bank	300
	11,680
Total assets	53,980
Equity and liabilities	
Equity attributable to owners of the parent	
Equity shares of $1 each ((10, 000 + 4,800) w (iv))	14,800
Other component of equity (share premium) (w (iv))	9,600
Revaluation surplus (2,000 + (600 x 80%))	2,480
Retained earnings (w (v))	6,765
	33,645
Non-controlling interest (w (vi))	4,800
Total equity	38,445
Non-current liabilities	
10% loan notes (2,500 + 1,000 – 1,000 intra-group)	2,500
Current liabilities	
Trade payables (3,400 + 3,600 – 800 intra-group)	6,200
Current tax payable (2,800 + 800)	3,600
Deferred consideration (1,800 + 135 w (v))	1,935
Bank (1,700 – 400 cash in transit)	1,300
	13,035
Total equity and liabilities	53,980

(c) IFRS 3 *Business Combinations* addresses the recognition of separable intangibles assets. Both of the items which the directors of Plastik have identified in the acquisition of Dilemma should be recognised as separate intangible assets on the acquisition of Dilemma. Both IFRS 3 *Business Combinations* and IAS 38 *Intangible Assets* require in-process research in a business combination to be separately recognised at its fair value provided this can be reliably measured ($1·2 million in this case). The recognition of customer list as an intangible asset is a specific illustrative example given in IFRS 3 (IE 24) and should also be recognised at its fair value of $3 million.

Workings (note figure in brackets are in $'000)

		$'000	$'000
(i)	**Cost of sales**		
	Plastik		45,800
	Subtrak (24,000 x 9/12)		18,000
	Intra-group purchases (300 x 9 months)		(2,700)
	URP in inventory (600 x 25/125)		120
	Additional depreciation on property		100
			61,320
(ii)	**Non-controlling interests in Subtrak's profit or loss**		
	Subtrak's profit as reported		2,000
	9/12 post-acquisition =		1,500
	Deduct: Additional depreciation on property		(100)
	Goodwill impairment		(500)
	Adjusted post-acquisition profit		900
	x 20% non-controlling interest		180

		$'000	$'000
(iii)	**Non-current assets**		
	Plastik		18,700
	Subtrak		13,900
	Fair value increase at acquisition		4,000
	Additional depreciation on property		(100)
	Fair value increase since acquisition		600
			37,100
(iv)	**Goodwill in Subtrak**		
	Investment at cost		
	Shares (9,000 x 80% x 2/3 x $3)		14,400
	Deferred consideration (9,000 x 80% x 27·5 cents x 1/1·1)		1,800
	Non-controlling interest (9,000 x 20% x $2·50)		4,500
			20,700
	Net assets (equity) of Subtrak at 30 September 2014	(12,500)	
	Less post-acquisition profits (2,000 x 9/12)	1,500	
	Fair value adjustment: property	(4,000)	
	Net assets at date of acquisition		(15,000)
	Goodwill on consolidation		5,700
	Impairment as at 30 September 2014		(500)
			5,200

Note: *The 4·8 million (9,000 x 80% x 2/3) shares issued by Plastik at $3 each would be recorded as share capital of $4·8 million (4,800 x $1) and share premium of $9·6 million (4,800 x $2).*

			$'000
(v)	**Retained earnings**		
	Plastik		6,300
	Subtrak's post-acquisition adjusted profit (900 (w (ii)) x 80%)		720
	Finance costs on deferred consideration (1,800 x 10% x 9/12)		(135)
	Unrealised profit in inventory (w (i))		(120)
			6,765
	Alternative calculation		
	Plastik's retained earnings at 30 September 2014		6,300
	Less Plastik's profit for the year		(8,000)
	Consolidated profit for the year from part (a)		8,465
			6,765
(vi)	**Non-controlling interest in statement of financial position**		
	At date of acquisition (w (iv))		4,500
	Post-acquisition from statement of profit or loss and other comprehensive income		300
			4,800

Fundamentals Level – Skills Module, Paper F7
Financial Reporting **December 2014 Marking Scheme**

This marking scheme is given as a guide in the context of the suggested answers. Scope is given to markers to award marks for alternative approaches to a question, including relevant comment, and where well-reasoned conclusions are provided. This is particularly the case for written answers where there may be more than one acceptable solution.

				Marks
Section A				
2 marks per question				**40**
Section B				
1	**(a)**	1½ marks per ratio		6
	(b)	1 mark per valid point. A good answer must emphasise the different interpretation when using adjusted figures		9
			Total for question	**15**
2	**(a)**	Schedule of retained earnings as at 30 September 2014		
		retained earnings per trial balance		½
		issue costs		1
		loan finance costs		1
		depreciation charges		2
		income tax expense		1½
				6
	(b)	Statement of financial position		
		property, plant and equipment		2
		current assets		½
		equity shares		½
		revaluation surplus		2
		deferred tax		1
		6% loan note		1½
		current liabilities (per trial balance)		½
		current tax payable		1
				9
			Total for question	**15**

			Marks
3	**(a)**	Consolidated statement of profit or loss and other comprehensive income:	
		revenue	1½
		cost of sales	2½
		distribution costs	½
		administrative expenses (including goodwill impairment)	1
		finance costs	1
		income tax expense	½
		gain on revaluation of properties	1
		non-controlling interest: profit for the year	1
		total comprehensive income	1
			10
	(b)	Consolidated statement of financial position:	
		property, plant and equipment	2
		goodwill	2½
		inventory	1
		trade receivables	1
		bank	½
		equity shares	1
		other component of equity (share premium)	1
		revaluation surplus	1
		retained earnings	1½
		non-controlling interest	1
		10% loan notes	1
		trade payables	1
		taxation	½
		deferred consideration	1
		bank overdraft	1
			17
	(c)	Recognition of: research	2
		customer list	1
			3
		Total for question	**30**