December Exam 2020 KEY

A. MULTIPLE CHOICE QUESTIONS (30%)

1	B	11	B
2	D	12	D
3	A	13	B
4	B	14	C
5	D	15	D
6	A	16	C
7	C	17	C
8	C	18	B
9	D	19	A
10	C	20	D

B. Exercises

Exercise # 1 (10%)

Required:

Prepare extracts (with proper explanation) from the statement of financial position of Biogenics at 31 December 20X9 relating to the above items and summarize the costs to be included in the statement of profit or loss for that year.

Biogenics

(a) To be recognised, an intangible asset must first of all meet the definition of an intangible asset in lAS 38 *Intangible Assets.* It must be controlled by the entity, it must be separately identifiable and it must be something from which the entity expects future economic benefits to flow. It must then meet the recognition criteria of having a cost that can be measured reliably:

For this reason internally-generated intangibles are not normally recognised as assets. They have not been acquired for a consideration and therefore do not have a cost or value that can be measured reliably. For this reason, a brand name that has been acquired can be capitalised, a brand name that has been internally developed cannot be capitalised. The exception to this is development costs which can be capitalised if/when they meet the lAS 38 criteria. They are initially recognised at cost.

After initial recognition development costs are amortised over the life cycle of the product. If at any point it becomes apparent that the development costs no longer meet the capitalisation criteria, they should be written off. Intangible assets with an indefinite useful life are not amortised but tested annually for impairment.

(b) STATEMENT OF FINANCIAL POSITION (extracts)

	$
Non-current assets	
Property, plant and equipment (W1)	187,500
Intangible assets (W2)	6,691,000
COSTS CHARGED TO PROFIT OR LOSS	
Depreciation (W1)	12,500
Amortisation (W2)	1,309,000
Staff salaries	400,000

Workings

1 *Computer equipment*

	$
Cost	200,000
Depreciation (200 x 3/48)	(12,000)
Carrying amount	187,500

2 ***Intangible assets***

	Patent	*Development Costs*	*Customer List*	*Total*
	$'000	$'000	$'000	$'000
Cost	1,500	6,000	500	8,000
Amortisation:				
(6/36)	(250)	(1,000)	--	--
(4/34)	--	--	(59)	(1,309)
	1,250	5,000	441	6,691

Exercise # 2 (15%)

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 20X8.

Epsilon

(a) In accordance with lAS 37 *Provisions, Contingent Liabilities and Contingent Assets* a restructuring provision can be made here. A detailed formal plan must be in place because by the end of the reporting period negotiations had already committed to sell the segment's assets and terminate its contracts. There is a valid expectation on the part of those affected because letters had been sent out (on 6 September) offering either relocation or voluntary redundancy.

Per lAS 37 the provision should only include costs that are directly related to the restructuring and not the entity's continuing operations.

i. Redundancy costs should be provided for. They are directly related to the restructuring and bear no relation to ongoing activities.
ii. Although Epsilon is committed to paying $8m into the pension plan, this is not provided for as part of the restructuring because it will be partially offset by the $7m reduction in future actuarial liabilities. The one-off additional retirement benefit cost of $1m is, however, brought

into the financial statements for the year ending 30 September 20X8, but as an increase in the liability for retirement benefits.

iii. Redeployment costs are specifically excluded by lAS 37 and should not be provided for.

iv. The anticipated loss on the sale of plant is not covered by lAS 37 but by I FRS 5 *Non-current Assets Held for Sale and Discontinued Operations.* The plant is measured at the lower of carrying amount ($11m) and fair value less costs to sell ($2m), and would be shown in a separate line in the statement of financial position 'Non-current assets held for sale '. The impairment loss is recognised in the statement of profit or loss at 30 September 20X8.

v. Operating losses are specifically excluded by lAS 37 and should not be provided for.

The total amount provided for would thus be $30m + $5.5m = $35.5m.

The fact that the directors had decided to close the business segment on 31 August does not of itself meet the conditions for recognising a provision.

The results of the business segment being closed do not need to be shown separately. It is not yet a discontinued operation as part of I FRS 5 because it has not yet been disposed of or classified as held for sale. It will, however, be one in the next financial year (ending 30 September 20X9). The segment would qualify as being 'abandoned ' per I FRS 5, and would therefore be a continuing operation until its closure in the next financial year. The segment would continue to be subject to the requirements of I FRS 8 *Operating Segments* until it is discontinued.

(b) The basic principle of lAS 20 A*ccounting for Government Grants and Disclosure of Government Assistance* is that grants should be recognised as income in whichever periods the costs they are intended to compensate occur.

i. There are no conditions attached to the $6m, so there are no costs to match the money to. Hence the $6m should be recognised as income straight away.

ii. The $15m relates to the costs of the factory and should be matched to them. The costs occur over the 40 year useful life, and lAS 20 allows the grant to be matched to them in two ways:

The grant could be used to reduce the cost of the asset and subsequent depreciation charges. The cost would have been $60m with $0.5m depreciation (=$60m/40 years x 4/12 months), but this would be reduced by the grant to $45m cost less $0.375m depreciation (= $45m/40 years x 4/12 months) to a carrying amount of $44.625m.

The other treatment would be to show the grant separately as deferred income, matching the income to the depreciation of the factory. The factory would remain at $60m cost with $0.5m depreciation. Income of $0.125m (= $15m/40 years x 4/12 months) would be recognised in the statement of profit or loss, with the remaining $14.875m being shown as deferred in the statement of financial position. Of this, $0.375m would be shown within current liabilities as it would be released during the next year(= $15m/40 years), and the remaining $14.5m (= $14.875m- $0.375m) would be in non-current liabilities.

iii. The question here is how likely it is that the grant will have to be repaid. In this case, it is possible but unlikely, so no liability needs to be recognised for it being repaid. The grant should therefore be treated as deferred income over the five years, of which \$0.6m (= \$9m/5 years x 4/12 months) is recognised as income this year. The doubt over possible repayment of the grant in future should then be disclosed as a contingent liability in line with IAS 37, as repayment is possible but not probable.

If it had been probable that the \$9m would have to be repaid, then no income would have been recognised in the statement of profit or loss and the full amount would be shown as a separate liability in the statement of financial position, reducing the amount of deferred income. If there was not enough deferred income to make up the amount of the liability (eg if some had already been recognised in the statement of profit or loss), then the deficit should be charged to the statement of profit or loss as an expense.

<u>Exercise # 3 (15%)</u>

Required: For each of the above situations, indicate (with proper quantification where possible) how shall the lessee treat the lease modifications in accordance with International Financial Reporting Standards.

The relevant discount factors are:

- The present value of an annuity of CU1 for 10 years at a rate of 6% is 7.3601
- The present value of an annuity of CU1 for 8 years at a rate of 7% is 5.9713
- The present value of an annuity of CU1 for 5 years at a rate of 5% is 4.3295

A. Lessee accounts for the modification as a separate lease, separate from the original 10-year lease. This is because the modification grants Lessee an additional right to use an underlying asset, and the increase in consideration for the lease is commensurate with the stand-alone price of the additional right-of-use adjusted to reflect the circumstances of the contract.

In this example, the additional underlying asset is the new 3,000 square metres of office space. Accordingly, at the commencement date of the new lease (at the end of the second quarter of Year 6), Lessee recognizes a right-of-use asset and a lease liability relating to the lease of the additional 3,000 square meters of office space. Lessee does not make any adjustments to the accounting for the original lease of 2,000 square meters of office space as a result of this modification.

B. At the inception of the lease, the lessee accounts for a right of use asset and a lease liability for the value of CU50,000 x 7.3601 = CU368,005. Subsequently the lessee amortizes the ROU asset on a straight line basis over the lease term (that is 10 years), and the liability by applying the actuarial method as per the below schedule:

	Lease Liability				**Right of use asset**		
	(1)	**(2)** = (1) x 6%	**(3)**	**(4)** = (1) + (2) – (3)	**(5)**	**(6)** = 368,005 /10	
Period	**Beg. Balance**	**Interest Expense**	**Lease payment**	**Ending Balance**	**Beg. Balance**	**Depreciation Expense**	**Ending Balance**
1	368,005	22,080	(50,000)	340,085	368,005	36,801	331,204
2	340,085	20,405	(50,000)	310,490	331,204	36,801	294,403
3	310,490	18,629	(50,000)	279,119	294,403	36,801	257,602
4	279,119	16,747	(50,000)	245,866	257,602	36,801	220,801
5	245,866	14,752	(50,000)	**210,618**	220,801	36,801	**184,000**

The balance of the ROU asset at the end of year 5 is CU184,000 and the one for the lease liability is CU210,618.

At the effective date of the modification (at the beginning of Year 6), Lessee remeasures the lease liability based on:

a) a five-year remaining lease term,
b) annual payments of CU30,000 and
c) Lessee's incremental borrowing rate of 5 per cent per annum. This equals CU30,000 x 4.3295, that is CU129,885.

Lessee determines the proportionate decrease in the carrying amount of the right-of-use asset on the basis of the remaining right-of-use asset (i.e. 2,500 square meters corresponding to 50 per cent of the original right-of-use asset).

- 50 per cent of the pre-modification right-of-use asset (CU184,000) is CU92,000.
- Fifty per cent of the pre-modification lease liability (CU210,618) is CU105,309.

Consequently, Lessee reduces the carrying amount of the right-of-use asset by CU92,000 and the carrying amount of the lease liability by CU105,309. Lessee recognizes the difference between the decrease in the lease liability and the decrease in the right-of-use asset (CU105,309 – CU92,000 = CU13,309) as a gain in profit or loss at the effective date of the modification (at the beginning of Year 6).

<u>Exercise # 4 (30%)</u>

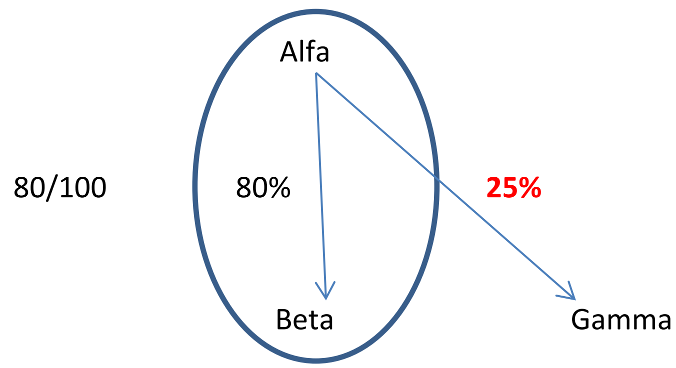
Required:

Prepare the consolidated statement of financial position for Alpha as at 31 March 2012.

ASSETS			
Non-current assets:			
Property, plant and equipment		**(23100+28500+3000-600 (FV adj)**	54,000
Goodwill	**W3**		8,500
Investments		**(41000-24000-1000(intra-group)-10000**	6,000
Investment in Associates-Gamma	**W6**		8,950
Current assets:			
Inventories		**(13900+10400-1000 (FV Adj)-500(PUP)+1500(in transit)**	24,300
Trade receivables	**W9**	**(11400+5500-1200(CIT W9)-3200(trading W9)**	12,500
Cash and cash equivalents	**W9**	**(9400+600+1200 Cash in transit (CIT W9)**	11,200
Total assets			125,450
EQUITY AND LIABILITIES			
Equity attributable to parent			
Share capital ($1 shares)		**(25000**	25,000
Share Premium		**(17600**	17,600
Retained earnings	**W5**		34,686
NCI	**W4**		8,544
Total equity			85,830
Non-current liabilities:			
Deferred tax		**(14000+3000+280 (FV Adj)**	17,280
10% Loan Notes		**(2500+1000-1000(intra-group)**	2,500
Total non-current liabilities			19,780
Current liabilities:			
Trade and other payables	**W9**	**(9500+5000+1500(Inv.in transit W9)-**	12,800

	3200(trading W9)	
Deferred consideration	**(6400+640 (W7)**	7,040
Total current liabilities		19,840
Total equity and liabilities		125,450

W1 Group Structure



Acquisition Date	01-Apr-11	01-Oct-11
Reporting Date	31-Mar-12	31-Mar-12
To Reporting	12 months	6 months
NCI %	**20%**	
NCI Measurement	Fair Value	

W2 Beta's Net assets

	(1)	(2)	(2)-(1)
	At Acquisition	At Reporting	Post Acquisition
Equity Share of $1 each	10,000	10,000	0
Retained earnings at 01 April 2011	18,000	18,000	0
– for year ended 31 March 2012	0	8,000	8,000
Fair Value Adjustment			
Plant	3,000	3,000	0
Acc. Dep Plant	0	(600)	(600)
Inventory	(5,000)	(1,000)	4,000
PUP Inventory - Beta is Seller (W8)	0	(500)	(500)
Deferred tax on FV Adj (20%)	400	(280)	(680)
	26,400	36,620	10,220

W3 Goodwill Calculation

		$'000	
	Fair value Consideration transferred		
	Shares 10000/$1x80%x1/2x$6	24,000	
	Deferred Cash PV=(10000/$1x80%x88/100)x1/(1+10%)	6,400	
add	Fair Value NCI 10000/$1x20%x$3.5	7,000	
less	Fair value Beta's net assets	(26,400)	
=	Goodwill at acquisition	11,000	
less	Impairment	(2,500)	
=	Goodwill at reporting	8,500	CSOFP

W4 Non-Controlling Interest

	Fair Value NCI at Acquisition (W3)	7,000
add	NCI % of Beta's reserves post acquisition	2,044
less	NCI % of Goodwill Impairment (FV)	(500)
		8,544

W5 Group Retained Earnings

		$'000
	Parent retained Earnings 16200+14000	30,200
add	Alpha's share of Beta's RE post acquisition	8,176
less	Unwinding the Discount on Deferred Cash (W7)	(640)
less	Goodwill Impairment/Alpha's Share (80%)	(2,000)
add	Alpha's share of Gamma's RE post acquisition 25%	150
less	Goodwill Impairment/Gamma	(1,200)
		34,686

W6 Investment in Gamma (Associates)

		$'000
	Cost of Investment at acquisition	10,000
add	Alpha's share of Gamma's reserves post acquisition 25%	150
less	Investment in Gamma impairment	(1,200)
		8,950

W7 Cash Consideration (Deferred)

Dr Cost of Investment	6,400	
Cr Deferred Consideration (Cash)		6,400

PV=(10000/$1x80%x88/100)x1/(1+10%) 6,400

Unwinding the discount (10%)

Dr Group Retained Earnings (W5)	640	
Cr Deferred Consideration (Cash)		640

6400x10%

W8 Intra-group sale of inventories (PUP)

Inventory remained with Alpha from intra-group at 31 March 2012

Sales from Beta to Alpha	16,000
Sales by Alpha outside the group	(14,500)
Inventory remained	1,500

PUP (50% Cost plus)
1500x50%/(1+50%) 500

W9 Intra-group Trade receivables and payables

The goods-in-transit and cash-in-transit need to be dealt with first.

Goods in transit:

Dr Inventory	1,500	
Cr Trade Payables		1,500

Cash in transit:

Dr Cash	1,200	
Cr Trade Receivables		1,200

This leaves $3,200 in receivables/payables, which can now be cancelled down.