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COURSE NOTES

Paper F7

FINANCIAL REPORTING
(INTERNATIONAL)

JUNE 2012 EXAMINATIONS

CONTENTS

Chapter 1

FINANCIAL REPORTING – BASIC CONCEPTS

Underlying assumptions

- accruals
- going concern
- consistency
- materiality
- off-setting

Example 1

Laima has recently bought a shop called Sweet for $1 million and included the full amount in her cost of sales account.

How does each of the five concepts affect the way Laima should treat the cost of $1 million?

Advantages and disadvantages of standardisation of accounting practices

- provide a focal point for debate
- require disclosure of policies adopted
- encourage global discussion
- flexible
- enable meaningful comparison
- reduce penumbral areas of divergent possibilities
- pressure groups may succeed in asking for amendments
- allowed alternative treatments – standardisation?
- inappropriate treatment could result from following a standard
- rules take away use of skill and judgement

A conceptual framework

- framework has been developed

  defined as "a constitution, a coherent system of interrelated objectives and fundamentals which can lead to consistent standards and which prescribe the nature, function and limits of financial accounting and financial statements"
- generally accepted accounting practice (gaap)
- a combination of:
  - each country's own law
  - international financial reporting standards
  - stock exchange requirements
- but gaap does not have any statutory authority
- changes and evolves with changing circumstances

The framework

- provides a set of principles
- purpose defined as assisting:-
  - IASC in development of new standards
  - review of existing standards
  - harmonisation of standards and procedures
  - reduction of penumbral areas of divergent possibilities
  - development of new standards by national accounting bodies
  - preparers of financial statements
  - auditors in forming audit opinions
  - users in their interpretation of financial statements

Framework contents

- objectives of financial statements
- underlying assumptions (accruals and going concern)
- qualitative characteristics (see next)
- elements of financial statements (assets, liabilities, equity, income, expenses and capital maintenance)
- recognition of the elements
- measurement
- concept of capital and capital maintenance
- as a set of principles, it requires entities to follow the spirit of the framework
- it's not a standard, so does not override any existing standard requirements
- nor does it define any standard for measurement or disclosure of any particular issue

Framework – qualitative characteristics

- understandable
- comparable
- relevant
- faithful representation
- complete
- material
- substance over form
- reliable
- neutral
- prudent

(you can remember framework contents. Mike says remember nine principles!)

Chapter 2

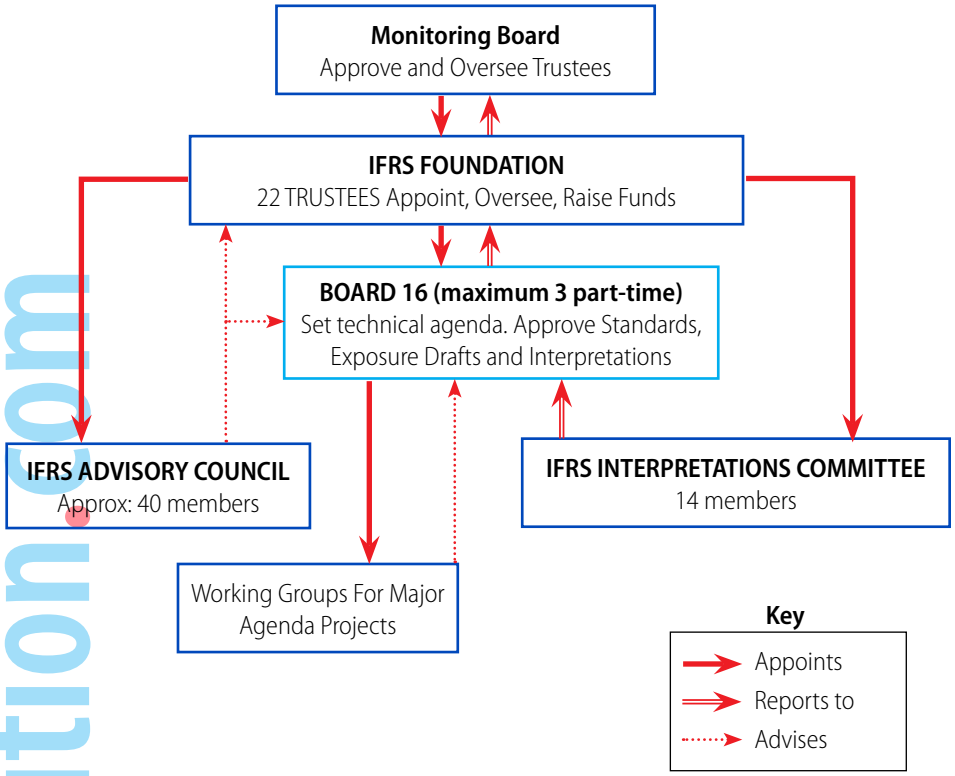
THE REGULATORY FRAMEWORK

- IFRS produced by the profession (IASC)
- identify required accounting treatment for items within financial statements
- sometimes with allowed alternatives
- reduce penumbral areas of divergent possibilities
- apply whenever financial statements intend showing a true and fair view
- non-compliance must be explained
- IASC has three formal objectives
  - to develop, in the public interest, a single set of high quality, understandable and enforceable global financial reporting standards that require high quality, transparent and comparable information in financial statements and other financial reporting to help global investors and other users make informed and meaningful economic decisions.
  - to promote the use and strict application of those standards; and
  - to bring about consistency of national and international financial reporting standards.

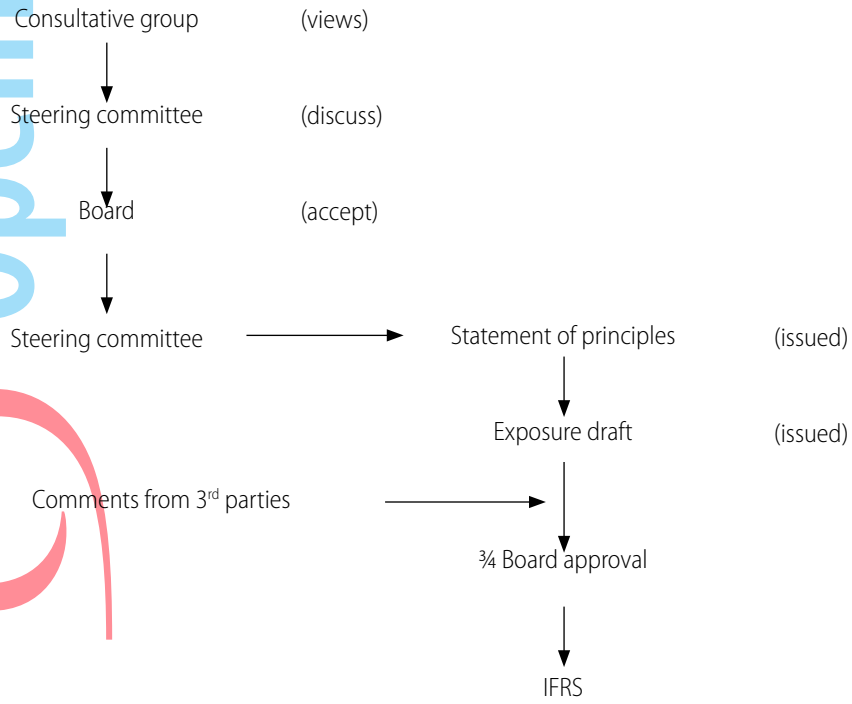
Example 1

What are the advantages and disadvantages of international harmonisation of financial reporting standards?

The structure of the IASB



- standard setting process



IFAC

- international federation of accountants
- mission: The mission of IFAC is "the development and enhancement of the profession to enable it to provide services of consistently high quality in the public interest"
- it is a non-profit, non-governmental and non-political international organisation of accountancy bodies.
- over 3 million members world-wide
- one representative from each member body on the assembly
- the assembly elects a council for two terms of 6 months
- council supervises the IFAC work programme
- work programme includes technical sub-committees on
  - international audit practices
  - ethics
  - education and training
  - financial accounting
  - management accounting

Financial statements comprise:

- Statement of financial position
- Statement of comprehensive income
- Statement of changes in equity
- Statement of cash flows
- Notes (accounting policy and explanations)
- some elements of the report of the executives are also auditable
  - remuneration committee's report
  - report on the appropriateness of the system of internal control
- purpose of IAS 1 (revised) is to ensure greater clarity and understandability of financial statements
- within the financial statements there should be disclosed
  - name of the entity
  - date of the end of the accounting period
  - period covered by the financial statements
  - reporting currency
  - degree of precision used
  - country of incorporation and address of registered office
  - description of the nature of operations
  - name of parent entity and ultimate holding entity
  - number of employees at end of period (or average during the period)

Chapter 3

PUBLISHED FINANCIAL STATEMENTS

- proforma financial statements following IAS1 (revised)

XYZ GROUP
Statement of Comprehensive Income for the year ended 31 December, 2009
(classification of expenses by function)

	2009	*2008*
	$'000	*$'000*
Revenue	X	X
Cost of sales	(X)	(X)
Gross profit	X	X
Other operating income	X	X
Distribution costs	(X)	(X)
Administrative expenses	(X)	(X)
Other operating expenses	(X)	(X)
Profit from operations	X	X
Finance cost	(X)	(X)
Income from associates	X	X
Profit before tax	X	X
Income tax expense	(X)	(X)
Profit after tax	X	X

XYZ GROUP
Statement of Financial Position as at 31 December, 2009

	2009	*2009*	*2008*	*2008*	*2007*	*2007*
	$'000	*$'000*	*$'000*	*$'000*	*$'000*	*$'000*
ASSETS						
Non-current assets						
Goodwill	X		X		X	
Property, plant and equipment	X		X		X	
Other financial assets	X		X		X	
		X		X		X
Current assets						
Inventories	X		X		X	
Trade and other receivables	X		X		X	
Prepayments	X		X		X	
Cash and cash equivalents	X		X		X	
		X		X		X
Total assets		X		X		X
EQUITY AND LIABILITIES						
Equity						
Issued capital	X		X		X	
Reserves	X		X		X	
Retained earnings	X		X		X	
Non-controlling interest	X		X		X	
		X		X		X
Non-current liabilities						
Interest bearing borrowings	X		X		X	
Deferred tax	X		X		X	
		X		X		X
Current liabilities						
Trade and other payables	X		X		X	
Short term borrowings	X		X		X	
Current tax	X		X		X	
Current portion of interest bearing borrowings	X		X		X	
		X		X		X
Total equity and liabilities		X		X		X

Statement of Changes in Equity

- IAS 1 (revised) requires an entity to disclose the information in the Statement of Changes in Equity as a separate component of its financial statements.

XYZ GROUP
Statement of Comprehensive Income for the year ended 31 December, 2009

	2009	*2008*
	$'000	*$'000*
Surplus/(deficit) on revaluation of properties	(X)	X
Surplus/(deficit) on revaluation of investments	X	(X)
Net gains not recognised in the Statement of Income	X	X
Net profit for the period	X	X
Total Comprehensive Income	X	X

XYZ GROUP
Statement of Changes in Equity for the year ended 31 December, 2009

	Share capital	*Share premium*	*Revaluation reserve*	*Retained earnings*	*Non-controlling Interest*	*Total*
	$000	*$000*	*$000*	*$000*	*$000*	*$000*
Balance at 31 December, 2007	X	X	X	X	X	X
Changes in accounting policies				(X)		(X)
Restated balance	X	X	X	X	X	X
Surplus on revaluation of properties			X		X	X
Deficit on revaluation of investments			(X)			(X)
Net Income and Expense not recognised in the Statement of Income			X		X	X
	X	X	X	X	X	X
Net profit for the period				X		X
Dividends				(X)	(X)	(X)
Non-controlling interest				(X)	X	
Issue of share capital	X	X				X
Balance at 31 December, 2008	X	X	X	X	X	X
Deficit on revaluation of properties			(X)		(X)	(X)
Surplus on revaluation of investments			X			(X)
Net income and expense not recognised in the Statement of Income			(X)		(X)	(X)
	X	X	X	X	X	X
Net profit for the period				X		X
Non-controlling interest				(X)	X	
Dividends				(X)	(X)	(X)
Issue of share capital	X	X				X
Balance at 31 December, 2009	***X***	***X***	***X***	***X***	***X***	***X***

Example 1

B Co Statement of Comprehensive Income extracts for the year ended 31 December, 2009

	$'000
Net profit for the year	421
Dividend	(98)
Retained profit	323

During the year the following important events took place:

(i) Properties were revalued by $105,000 increase.

(ii) $200,000 of $1 share capital was issued during the year at a 25c premium

(iii) A non-current asset with a carrying value of $130,000 was written down to $95,000. The impairment occurred as a result of general price changes. The revaluation surplus account contains $25,000 relating to this asset.

(iv) Opening equity was:

	$
Issued capital	400,000
Share premium	50,000
Revaluation surplus	165,000
Retained earnings	310,000
	925,000

Show how the events for the year would be shown in the Statement of Changes in Equity.

- the notes to the financial statements should present information about the basis of preparation of the financial statements and the accounting policies selected. They should disclose all information required by IFRS not disclosed elsewhere in the financial statements.

- in addition they should disclose any additional information not disclosed on the face of the financial statements, but which is necessary for a true and fair view.

- **accounting policies**

  - the financial statements are prepared in accordance with and comply with IFRS. The financial statements are prepared under the historical cost convention as modified by the revaluation of property, plant and equipment, marketable securities and investment properties.

  - depreciation is calculated on the straight line basis in order to write off the cost of each asset, or the revalued amounts, to their residual values over their estimated useful life as follows:

Buildings	X%
Machinery	X%
Office equipment	X%

  - Inventories have been valued at the lower of cost and net realisable value.

- **segment information**

you could be expected to analyse (in an interpretation question) segmented information

- **profit from operations**

Profit from operations is stated after charging/ (crediting):	
Depreciation	X
Impairment	X
Profit on disposal of tangible non-current assets	(X)
Gain or loss on disposal or restatement to fair value of financial instruments	(X)
Write-down of inventory to net realisable value	X
Amortisation	X
Research and development expenditure	X
Operating lease rentals	X
Staff costs	X
Rental income from investment property	(X)
Operating expenses from investment property generating rental income	X
Operating expenses from investment property not generating rental income	X
Amounts paid to the auditors	X

- **staff costs**

Wages and salaries	X
Termination benefits	X
Social security costs	X
Pension costs - defined contribution plan	X
Pension costs - defined benefit plan	X
Other post retirement benefits	X
	X
Average weekly number of persons employed during the year:	
Full time	X
Part time	X
	X

Note:
Average number
Either the number of employees at the end of the period or the average for the period.

- **finance costs**

Interest income (if material)	X
Interest expense	
- bank borrowings	X
- finance leases	X
Preference dividend 8.1% paid	X
	X
	X

- **income tax expense**

Current tax	X
Under/(overstatement) of prior periods	X/(X)
Deferred tax	X
	X

- **dividends**

Ordinary			
- interim	4.15c	paid	X
- final	7.85c	proposed	X
			X

Note
Show the amount per share for each class of share distinguishing between amounts paid and proposed, (if proposed before the year end)

- **intangible assets**

	Deferred Development Expenditure	*Goodwill*	*Total*
Net book value at 1 January, 2009	X	X	X
Additions	X	X	X
Impairment losses	(X)	(X)	(X)
Amortisation	(X)		(X)
Disposals	(X)	(X)	(X)
Net book value at 31 December, 2009	X	X	X
At 31 December, 2009			
Cost	X	X	X
Accumulated amortisation/impairment losses	(X)	(X)	(X)
Net book value	X	X	X
At 1 January, 2009			
Cost	X	X	X
Accumulated amortisation/impairment losses	(X)	(X)	(X)
Net book value	X	X	X

- **property, plant and equipment**

	Land and buildings	*Machinery*	*Office equipment*	*Total*
Net book value at 1 January, 2009	X	X	X	X
Additions	X	X	X	X
Revaluation surplus	X	-	-	X
Impairment losses	(X)	(X)	-	(X)
Depreciation charge	(X)	(X)	(X)	(X)
Disposals	(X)	(X)	(X)	(X)
Net book value at 31 December, 2009	X	X	X	X
At 31 December, 2009				
Cost or valuation	X	X	X	X
Accumulated depreciation/impairment losses	(X)	(X)	(X)	(X)
Net book value	X	X	X	X
At 1 January, 2009				
Cost or valuation	X	X	X	X
Accumulated depreciation/impairment losses	(X)	(X)	(X)	(X)
Net book value	X	X	X	X

- Included within the net book value of plant and machinery is $X in respect of assets held under finance leases (IAS 17 revised)

Note

- The following should be disclosed separately (IAS 16 revised):
  - any restrictions on title of property, plant and equipment pledged as security for liabilities
  - the amount of expenditure on property, plant and equipment in the course of construction
  - the amount of capital commitments for the acquisition of property, plant and equipment

- **revaluations in the year (IAS 16 revised)**
  - For items of property, plant and equipment revalued disclose:
    - basis used to revalue the assets;
    - the effective date of the revaluation;
    - where an independent valuer was involved, the name and/or qualifications
    - the historic cost equivalent of the above information as if the asset had not been revalued (ie if using the benchmark treatment); and
    - the amount of the revaluation surplus.

- **investment properties (IAS 40)**

	Fair Value Model	*Cost Model*
At 1 January, 2009	X	X
Additions - acquisition	X	X
Additions - subsequent expenditure	X	X
Transfers	X/(X)	X/(X)
Net gain/loss from fair value adjustments	X	-
Disposals	(X)	(X)
Depreciation	-	(X)
Impairment losses	-	(X)
Other movements	X	X
At 31 December, 2009	X	X
At 31 December, 2009		
Gross carrying amount		X
Accumulated depreciation/ impairment losses		(X)
Net book value		X
At 1 January, 2009		
Gross carrying amount		X
Accumulated depreciation/ impairment losses		(X)
Net book value		X

- **inventories (IAS 2 revised)**

Merchandise	X
Production supplies	X
Materials	X
Work in progress	X
Finished goods	X
	X

The carrying amount of inventories carried at net realisable value should be disclosed separately

- **trade and other receivables**

Trade receivables	X
Amounts receivable from group undertakings	X
Amounts receivable from associates and joint ventures	X
Amounts receivable from related parties	X
Other receivables	X
Prepayments	X
	X

Non-current receivables should be disclosed separately broken down by the above categories

- **cash and cash equivalents (IAS 7 revised)**

Cash in hand and balances with banks	X
Short-term investments	X
	X

Cash includes cash in hand and current and other accounts with banks. Cash which is not immediately available for use, for example, balances frozen in foreign banks by exchange restrictions, should be disclosed separately.

- **issued share capital**

	Number of shares	*Equity shares*	*Share premium*	*Total*
		$'000	*$'000*	*$'000*
At 1 January, 2009	X	X	X	X
Issue of shares	X	X	X	X
At 31 December, 2009	X	X	X	X

The total number of shares is Xm with a par value of $1 per share. All shares issued are fully paid (disclose any which are not).

- **interest-bearing borrowings**

9% unsecured loan stock 2020	X
8.1% redeemable preference shares	X
	X

- **finance lease liabilities**

see separate chapter.

- **trade and other payables**

Trade payables	X
Amounts payable to group undertakings	X
Amounts payable to associates and joint ventures	X
Income tax	X
Social security and other taxes	X
Dividends payable	X
Other payables	X
Accrued expenses	X
	X

Note

- Details of security given for all secured payables.
- Include only the current portion of instalment payables,
- The non-current portion is disclosed in the note for non-current liabilities.

- **provisions**

Provision brought forward at 1 January, 2009	X
Additional provisions	X
Amounts used	(X)
Unused amounts reversed	(X)
Provision carried forward at 31 December, 2009	X

The following should be disclosed for each class of provision:

- a brief description of the nature of the obligation and expected timing of outflows
- an indication of the uncertainties about the amount or timing of the outflows
- the amount of any expected reimbursement

- **contingent assets and contingent liabilities** IAS 37

(see separate chapter)

- **events after the reporting period (IAS 10 revised)**

The following should be disclosed for non-adjusting events of such importance that non-disclosure would influence the ability of the user of the financial statements to make proper evaluations and decisions:

- the nature of the event
- an estimate of the financial effect or a statement that such an estimate cannot reasonably be made, and
- an explanation why.

Chapter 4

IFRS5 – DISCONTINUED OPERATIONS AND ASSETS HELD FOR SALE

Objective

- to require entities to disclose information about operations which have been discontinued during the accounting period
- improves the reader's ability to interpret the results and to make meaningful projections
- a non-current asset held for sale is one where the carrying amount will be recovered principally through sale rather than through continuing use
- a disposal group is a group of (net) assets to be disposed of in a single sale transaction
- **to be classified as ' held for sale '**
  - it must be available for immediate sale in its present condition…
  - ...subject only to terms that are usual and customary for sales of such assets, and
  - its sale must be highly probable (see next)
- for a sale to be highly probable
  - management must be committed to a plan to sell the asset
  - an active programme to locate a buyer must have been started
  - as also must be a programme to complete the plan
  - the asset must be being actively marketed at a price that is reasonable in relation to its current fair value
  - the sale should be expected to take place within twelve months from the date of classification as 'held for sale '
  - it should be unlikely that significant changes to the plan will be made or that the plan will be withdrawn
- measurement – lower of carrying value and fair value less costs to sell
- impairment loss to be recognised if fair value is less than carrying value
- held for sale assets should not be depreciated even though they may still be in use

Discontinued operation

- a discontinued operation is a component of an entity that has either ……
- ...been disposed of, or...
- ...has been classified as held for sale
- additionally it should
  - represent a separate major line of business or geographical area of operations, or...
  - ...is part of a single co-ordinated plan to dispose of a separate major line of business or geographical area of operations , or...
  - ...is a subsidiary acquired exclusively with a view to re-sell
- a 'component' of an entity comprises operations and cash flows which can be clearly distinguished from the rest of the entity, both operationally and for financial reporting purposes
- in order to be classified as discontinued the sale or termination must actually have taken place by the end of the accounting period

IFRS 5 – presentation

- assets and liabilities held for sale should be presented separately from other assets and liabilities in the statement of financial position
- assets and liabilities should not be off-set
- the major classes of assets and liabilities must be separately disclosed on the face of the statement of financial position or in the notes
- presentation of discontinued operations on the statement of comprehensive income:-
  - post tax profit or loss from discontinued operations
  - post tax impairment to bring the discontinued operations to their recoverable amount
- by way of note (or on the statement of comprehensive income)
  - revenue, expenses and pre-tax profit or loss from discontinued operations
  - related tax expense
  - gross amount of impairment to bring the discontinued operations to their recoverable amount, and….
  - ….the related tax expense
- on the statement of cash flows, must show the cash flows from operating, investing and financing activities attributable to the discontinued operations

Additional disclosures

- description of the non-current asset (or disposal group)
- description of the facts and circumstances of the sale or disposal and…..
- ….the expected manner and timing of the disposal
- details of any impairment loss recognised when the asset was classified as held for sale
- if applicable, disclose the segment in which the asset held for sale is included
- where classification as held for sale is after the accounting period end but before the date of approval of the financial statements, it should be disclosed as a non-adjusting event
- most of the additional disclosures apply also where an operation has been discontinued during the year

Proforma disclosure as a note

- on 1 January, 2009 the entity announced its intention to sell its building operations. The sale was completed on 31 July, 2009 and the building activities are reported as a discontinued operation.
- the results and cash flows of the discontinued operation for the current period at the date of disposal were as follows:

Revenue	60
Operating expenses	(55)
Costs of discontinuance	(45)
Loss from operations	(40)
Interest expense	(15)
Loss before tax	(55)
Income tax	16
Loss after tax	(39)
Operating cashflows	(X)
Investing cashfows	X
Financing cashflows	(X)
	X
The assets and liabilities disposed of were as follows:	
Property, plant and equipment	X
Current assets	X
Total assets	X
Total liabilities	(X)
Loss on disposal before tax	(X)
Tax charge thereon	X
	(X)

Example 1

Ruta Co Statement of Comprehensive Income for the year ended 31 December, 2009

	$000 *2009*	*$000* *2008*
Revenue	700	550
Cost of sales	(300)	(260)
Gross profit	400	290
Distribution costs	(100)	(70)
Administrative expenses	(70)	(60)
Profit from operations	$230	$160

During the year the entity ran down a material business operation with all activities ceasing on 30.3.2009 The costs attributable to the closure amounted to $5,000 charged to administrative expenses. The results of the operation for 2009 and 2008 were as follows:

	$000 *2009*	*$000* *2008*
Revenue	60	70
Cost of sales	(40)	(45)
Distribution costs	(13)	(14)
Administrative expenses	(10)	(12)
Loss from operations	$(3)	$(1)

The entity made gains of $7,000 on the disposal of non-current assets of the discontinued operation. These have been netted off against administrative expenses.

Prepare the Statement of Comprehensive Income for the year ended 31 December, 2009 for Ruta Co, complying with the provisions of IFRS 5, disclosing the information on the face of the Statement of Comprehensive Income. Ignore taxation.

Chapter 5

IAS 8

Net profit or loss for the period, fundamental errors and changes in accounting policies

- all income and expenses must be included when arriving at profit for the period unless another IAS states differently
- a change in accounting policy should be adjusted in the prior period
- a correction of a fundamental error should be adjusted in the prior period
- transactions involving shareholders (dividends, share issues, redemptions etc) should not be included – these are shown on the statement of changes in equity
- in arriving at profit from ordinary activities, an entity should disclose those matters which are relevant to a fuller understanding of the entity's performance
- **examples in the IAS include:-**
  - write down of inventories
  - impairment of assets to recoverable amount
  - restructuring costs
  - profits (losses) on disposal of non-current assets
  - court case settlements

Changes in accounting estimates

- should be adjusted in the current period
- examples include:-
  - provisions for doubtful debts
  - changes in useful lives of depreciable assets
- any adjustment should be treated consistently by including them in the statement of comprehensive income classification as previously used
- the nature and amount of any change in accounting estimate having a material impact should be disclosed

Fundamental errors

- fundamental errors are those of such significance that the financial statements of a prior period can no longer be considered to have been reliable as at the date of issue.
- accounting treatment of fundamental errors:
  - adjust the opening balance of retained earnings, and
  - restate comparative information
- **disclosure**
  - nature
  - amount of correction in current and prior periods
  - amount of correction relating to periods before the comparatives
  - the fact that comparatives have been restated

Example 1

Adomas Co Statement of Comprehensive Income extract and summarised Statement of Financial Position for the year ended 31 December, 2008

	$'000
Revenue	2,500
Cost of sales and expenses	(1,200)
Profit for the year	1,300
Statement of Financial Position at 31 December, 2008	
Non-current assets	2,000
Current assets	800
	2,800
Share capital	600
Reserves	2,000
	2,600
Current liabilities	200
	2,800

During 2009 it was discovered that certain non-current assets had been included in the records at 31 December 2008 at $500,000 in excess of their recoverable amount and that this situation was unlikely to change.
Prior to making any adjustment for the above the results and summarised Statement of Financial Position of Adomas Co for 2009 was as follows:

Statement of Comprehensive Income extract for the year ended 31 December, 2009

	$'000
Revenue	2,600
Costs and expenses	(1,400)
Profit for the year	1,200
Statement of Financial Position at 31 December, 2009	
Non-current assets	2,800
Current assets	1,700
	4,500
Share capital	600
Retained earnings	3,500
	4,100
Current liabilities	400
	4,500

During 2009 some other items of property had been revalued by $300,000 (included in the above retained earnings figure)

Prepare extracts from Adomas Co's financial statements for the year ended 31 December, 2009.

Changes in accounting policy

- normally, policies should be applied consistently from one period to the next. Changes are therefore rare

- **changes should only be made if:**
  - required by statute
  - required by international financial reporting standard
  - change will result in financial statements which are:
    - more relevant and no less reliable or
    - more reliable and no less relevant

- **accounting treatment:**
  - adjust opening balance of retained earnings
  - restate comparative information

- **disclosure**
  - reasons for the change
  - amount of the adjustment for each period presented
  - amount of the adjustment relating to periods before the comparatives
  - the fact that comparatives have been adjusted

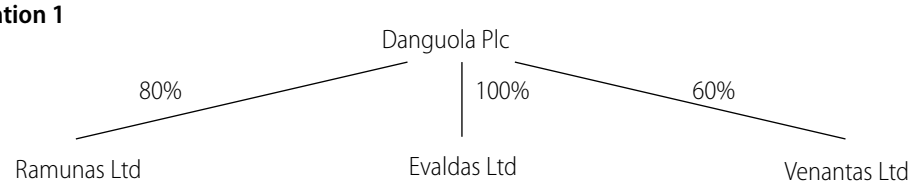
Chapter 6

GROUP ACCOUNTS: AN INTRODUCTION

Issue

- entities may expand organically by building up their business from their own trading, or by acquisition (ie by acquiring control of other entities).

Illustration 1



- **types of acquisition**
  - when an entity acquires a sole trader or partnership, it acquires individual assets and liabilities which are added to its statement of financial position, since it now owns them.
  - all profits and losses, which the sole trader's assets would generate, are now under the entity's control and reported in its statement of comprehensive income.
  - when it acquires control of another entity, it is done by acquiring shares rather than individual assets and liabilities.
  - the investment in the acquiring entity's books is represented by the ownership of shares, which in turn represents control of the acquired entity's net assets.
  - after the transaction the acquired entity will continue to exist as a separate legal person with its continuing national legislative reporting responsibilities.

IFRS 10

- explains in detail the concept of "control"
- investor controls an investee when the investor
  - is exposed to, or
  - has rights to
  - variable returns from its involvement, and
  - has the ability to affect those returns through its power over the investee
- the IFRS extends the objective test of ownership of >50% of voting shares
- adopts a principles based approach
- investor needs regularly to reassess whether control still exists
- control exists when the investor
- can exercise the majority of voting rights in the investee
- is in a contractual arrangement with others giving control
- holds <50% of the voting rights, but the remainder are widely distributed
- holds potential voting rights which will give control at some time in the future

Illustration 2
The Statements of Financial Position of Vytautas and Gediminas at 1 January, 2009 are as follows:

	Vytautas		*Gediminas*	
	$	$	$	$
ASSETS				
Non-current assets				
Plant and equipment		50,000		9,000
Current assets				
Inventory	8,000		4,000	
Receivables	6,000		2,000	
Cash	4,000		1,000	
		18,000		7,000
Total assets		68,000		16,000
EQUITY AND LIABILITIES				
Capital and Reserves				
Share capital		40,000		400
Retained earnings		20,000		2,600
		60,000		3,000
Current liabilities		8,000		13,000
Total equity and liabilities		68,000		16,000

Vytautas acquires 100% of the share capital of Gediminas on 1 January, 2009 for $3,000 in cash.

- **parent entity Statement of Financial Position**
  - under IFRS3 (Consolidated Financial Statements and Accounting for Investments in Subsidiaries), the investment can be recorded in the holding entity's books in one of two ways:
    - carried at cost
    - accounted for as an asset held for sale as described in IFRS 5.
  - an asset held for sale in this case represents an investment in shares in another entity held for short-term profit-making by trading those shares. It should initially be recognised at cost and from then on at its fair value.
  - in these notes, it is assumed that the investment is recorded in the holding entity's individual records at cost.

Example 1

Show how Vytautas will record this investment and prepare the revised Statement of Financial Position of Vytautas as at 1 January, 2009

- **features of the parent entity Statement of Financial Position**
  - shows investment as an interest in shares at cost. This will remain unchanged from year to year.
  - other net assets remain unchanged, reflecting only those assets and liabilities held by Vytautas directly.

Illustration 3

A year later, the respective Statements of Financial Position are as shown:

	Vytautas	*Gediminas*
	$	*$*
ASSETS		
Non-current assets		
Plant and equipment	55,000	10,000
Investment in Gediminas	3,000	-
	58,000	10,000
Current assets	20,000	12,000
Total assets	78,000	22,000
EQUITY AND LIABILITIES		
Share capital	40,000	400
Retained earnings	25,000	9,600
	65,000	10,000
Current liabilities	13,000	12,000
Total equity and liabilities	78,000	22,000

Is Vytautas providing its shareholders with useful information? Clearly not!

Note

- The investment remains static at its historic cost.
- While under Vytautas' ownership and control Gediminas' net assets have increased significantly.

Solution

The solution to the information gap illustrated above depends on the type of investment Vytautas has in Gediminas

Types of investment

Example 2

Size of investment	*Extent of influence achieved*	*Accounting treatment*
0% to < 20%		
20% ≤ 50%		
> 50%		

Provided Vytautas has a controlling influence it is required to produce an additional set of financial statements which aim to record the substance of its relationship with Gediminas rather than its strict legal form.

- this additional set of financial statements is referred to as group, or consolidated, financial statements.

- **Consolidated Statement of Financial Position**

in addition to its own Statement of Financial Position Vytautas Co also has to reflect the commercial substance of its investment

Vytautas Consolidated Statement of Financial Position at 31 December, 2009

	$
Assets	
Non-current assets	
Plant and equipment	65,000
Current assets	32,000
	97,000
EQUITY AND LIABILITIES	
Share capital	40,000
Retained earnings	32,000
	72,000
Current liabilities	25,000
	97,000

- features of the Consolidated Statement of Financial Position
  - no investment.
  - the assets and liabilities are now those within the control of Vytautas, ie the resources available to the group.
  - share capital is only that of the parent entity because these financial statements are prepared for the shareholders of Vytautas.
  - the retained earnings comprises Vytautas' own retained earnings plus its share (100%) of Gediminas' retained earnings made since Vytautas acquired its investment, that is (9,600 – 2,600) × 100%

Definition of a subsidiary (IAS 27)

- a ***subsidiary*** is an entity controlled by another entity.
- control is the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities.
- control is presumed to exist when the parent owns, directly or indirectly through subsidiaries, more than one half of the voting power of an entity unless, in exceptional circumstances, it can be clearly demonstrated that such ownership does not constitute control.
- control also exists when the parent owns half or less of the voting power of an entity when there is:
  - power over more than half the voting rights by virtue of an agreement with other investors;
  - power to govern the financial and operating policies of the entity under statute or agreement;
  - power to appoint or remove the majority of the directors or equivalent governing body; or
  - power to cast the majority of votes at meetings of the directors or equivalent governing body.

Chapter 7

PREPARATION OF THE CONSOLIDATED STATEMENT OF FINANCIAL POSITION

Issue

- consolidation is the process of adjusting and combining financial information from the individual financial statements of a parent undertaking and its subsidiary undertakings to prepare consolidated financial statements that present financial information for the group as a single economic entity.

- the Consolidated Statement of Financial Position reflects the assets and liabilities within the control of the parent entity, and how they are owned.

- defined by IAS 27 Consolidated Financial Statements and Accounting for Investments in Subsidiaries, consolidated financial statements are "the financial statements of a group presented as those of a single entity".

Example 1

Rasa acquired 100% of the shares of Tatjana on 1 January, 2009 for $18,000. At that date the Statements of Financial Position were as follows:

	Rasa	*Tatjana*
	$	*$*
Investment in Tatjana	18,000	-
Other assets	30,000	20,000
	48,000	20,000
Share capital	20,000	8,000
Retained earnings	22,000	10,000
	42,000	18,000
Liabilities	6,000	2,000
	48,000	20,000

Prepare the Consolidated Statement of Financial Position of the Rasa Group as at 1 January, 2009

(Aggregate the two Statements of Financial Position.)

Rasa Group Consolidated Statement of Financial Position as at 1 January, 2009

- ***Note***

  - share capital is always, only, ever the share capital of the parent entity.

  - the retained earnings of $10,000 in Tatjana were all achieved prior to Rasa gaining control, and since this question asks for a CSoFP as at date of acquisition, then there has been no opportunity for Tatjana to make any profits subsequent to Rasa gaining control. Therefore, in this example, the consolidated retained earnings are simply those of Rasa.

Post-acquisition reserves

Example 2

One year later, 31 December, 2009 the Statements of Financial Position of Rasa and Tatjana are as follows:

	Rasa	*Tatjana*
	$	*$*
Investment in Tatjana	18,000	
Other assets	40,000	26,000
	58,000	26,000
Share capital	20,000	8,000
Retained earnings	31,000	14,000
	51,000	22,000
Liabilities	7,000	4,000
	58,000	26,000

Prepare the Consolidated Statement of Financial Position of the Rasa Group as at 31 December, 2009.

- ***Note***

  - the Consolidated Statement of Financial Position shows the assets which are under the control of Rasa, rather than the investment in shares of Tatjana

  - the share capital is always, only, ever that of the parent entity, because the group financial statements are prepared for the benefit of Rasa's shareholders only.

  - included in the Consolidated Statement of Financial Position are Rasa's share of the profits less losses made by Tatjana since acquisition.

Example 3 - Comprehensive example

Aurimas acquired 100% of Oleg for $20,000 when the Statement of Financial Position of Oleg was as follows:

	$
Other assets	23,000
Share capital	12,000
Retained earnings	8,000
	20,000
Liabilities	3,000
	23,000

On 31 December, 2009 the Statements of Financial Position of the two entities are as follows:

	Aurimas	*Oleg*
	$	$
Investment in Oleg	20,000	-
Other assets	40,000	30,000
	60,000	30,000
Share capital	10,000	12,000
Retained earnings	42,000	15,000
	52,000	27,000
Liabilities	8,000	3,000
	60,000	30,000

Prepare the Consolidated Statement of Financial Position of the Aurimas Group as at 31 December, 2009

- ***Note***
  - net assets controlled by the group are $59,000 (assets of $70,000 less liabilities of $11,000)
  - since Oleg is a 100% subsidiary, Aurimas also owns net assets of $27,000 ie ($30,000 – $3,000)
  - the consolidated retained earnings comprise the whole of Aurimas' retained earnings ($42,000) plus Aurimas' share (100%) of Oleg's retained earnings made since acquisition ($15,000 - $8,000)

Complications

- **goodwill**
  - so far, the cost of the investment has equalled the value of the identifiable net assets acquired and therefore the buying entity has not paid any surplus over the worth of the subsidiary
  - where the cost of investment is greater than the fair value of the net assets acquired, the investor has paid for something more than the tangible net assets of the acquired business.
  - the difference is called GOODWILL and is defined in IFRS 3 Business Combinations as:
  - future economic benefits arising from assets that are not capable of being individually identified and separately recognised
- **accounting treatment of goodwill**
  - the accounting treatment of goodwill on acquisition of a subsidiary is governed by IFRS 3. It states that purchased positive goodwill should be capitalised and subjected to an annual impairment review.
- **negative goodwill arising on acquisition**
  - an acquirer should review at the first year end after the acquisition the fair value of assets on acquisition.
  - if negative goodwill still results, this should be credited to the Statement of Comprehensive Income at the earliest opportunity

Example 4

Maruta acquired the entire share capital of Liene for $30,000 on 1 January, 2009 when the Statements of Financial Position of the two entities were as follows:

	Maruta	*Liene*
	$	$
Investment in Liene	30,000	-
Other assets	40,000	27,000
	70,000	27,000
Share capital	25,000	15,000
Retained earnings	36,000	5,000
	61,000	20,000
Liabilities	9,000	7,000
	70,000	27,000

Prepare the Consolidated Statement of Financial Position of the Maruta Group as at 1 January, 2009

Goodwill will be an intangible non-current asset in the top half of the Statement of Financial Position

- ***Note***
  - net assets controlled by the group are $61,000
  - share capital is always, only, ever that of the parent entity.

Non-controlling interests

- non-controlling interests arise where the parent entity controls a subsidiary but does not own 100% of it

- ***Note***
  - remember you do not have to own 100% of an entity to control it
  - the group financial statements will need to show the extent to which the assets and liabilities are controlled by the parent entity but are owned by other parties, namely the non-controlling interests.

Workings

- **(W1) Group Structure, as normal**

- **(W2) Goodwill**

Cost of investment		X
NCI investment valuation		X
		X
Net assets @ doa		
Shares	X	
Retained earnings	X	
		X
Goodwill		X
Impaired since acquisition		(X)
Therefore, on CSoFP		(X)

- **(W3) Consolidated retained earnings**

	P	S
per question	X	X
- pre acquisition		(X)
∴ post acquisition	–	X
p's share	X	? %
Post acquisition	X	
Less: goodwill impaired since acquisition (parent's share only)	(X)	
CSoFP	X	

- **(W4) Non-controlling Interest (? %)**

They want their share of the subsidiary net assets at Statement of Financial Position date

Value of nci investment at date of acquisition	X
Their share of S post acquisition retained	X
Less: their share of goodwill impairment	X
Nci on CSoFP	(X)
	X

Example 5

Ausra acquires 60% of the issued share capital of Dainius at the date of Dainius' incorporation on 1 January, 2009. One year later the two entities have the following Statements of Financial Position.
Goodwill is impaired by 25%

	Ausra	*Dainius*
	$	*$*
Investment in Dainius	16,000	-
Other assets	24,000	30,000
	40,000	30,000
Share capital	18,000	20,000
Retained earnings	20,000	6,000
	38,000	26,000
Liabilities	2,000	4,000
	40,000	30,000

The directors valued the non-controlling interest at their proportionate share of the fair value of Dainius' net assets

Prepare the Consolidated Statement of Financial Position of the Ausra Group as at 31 December, 2009

- ***Note***
  - the assets and liabilities on the Statement of Financial Position show what the group CONTROLS.
  - the equity section of the Statement of Financial Position shows who actually OWNS the consolidated net assets of the group.

The non-controlling interest in the goodwill of the subsidiary creates additional complications

- there are two distinct ways of guiding you in the calculation
- the examiner may say either:
  - the parent company policy is to value the non-controlling interest as their proportional share of the subsidiary's fair valued net assets at date of acquisition, or
  - the parent company policy is to value the non-controlling interest as their fair share of the market value of the shares held by them.
- the key is the use of the word "proportional" or "proportion" or "proportionate"

Example 6

Remigijus acquires 75% of the issued share capital of Ilona for $80,000 when the Ilona retained earnings were $60,000. It is the policy of the directors to value the non-controlling interest as their proportional share of the subsidiary fair valued net assets at date of acquisition. Two years later on 31 March, 2010 the respective Statements of Financial Position were:

	Remigijus	*Ilona*
	$	*$*
Investment in Ilona	80,000	-
Other assets	100,000	150,000
	180,000	150,000
Share capital	50,000	32,000
Retained earnings	90,000	98,000
	140,000	130,000
Liabilities	40,000	20,000
	180,000	150,000

Prepare the Consolidated Statement of Financial Position of the Remigijus Group as at 31 March, 2010.
NB. Goodwill has not been impaired since acquisition

- but where the examiner tells us the value of the NCI is based on their fair share of the market value of the subsidiary
- information may be given in either of two ways
- the exam question could say, for example, either
  - goodwill attributable to the NCI on acquisition was $2,000, or

- the NCI investment was estimated at $30,000, or
- the market value of the subsidiary shares immediately before acquisition was $4.

- looking at each possibility in turn:

Example 7

Ivona bought 60% of the shares of Guido for $100,000 when the Guido retained earnings were $40,000. The value of the NCI investment was estimated as $55,000. Goodwill has not been impaired since acquisition.
At 30 June, 2010, the respective Statements of Financial Position were:

	Ivona	*Guido*
	$	*$*
Investment in Guido	100,000	-
Other net assets	60,000	190,000
	160,000	190,000
Share capital	70,000	80,000
Retained earnings	90,000	110,000
	160,000	190,000

Prepare the Consolidated Statement of Financial Position as at 30 June, 2010

The other possibility which you could face is where the examiner gives a value for the Guido shares.

Example 8

Using Ivona and Guido, but with the information that the Guido shares were worth $1.65 immediately before the acquisition by Ivona, prepare the Consolidated Statement of Financial Position as at 30 June, 2010.

- there is a further complication which arises when goodwill is to be impaired.
- in the last of the Ivona / Guido examples, goodwill was $32,800
- now suppose that this goodwill is to be impaired by 10%
- 10% × $32,800 is $3,280 and this amount is allocated on the basis of shareholdings ie on a 60% / 40% basis

Example 9

Recalculate W2, W3 and W4 for the other Ivona / Guido example on the assumption that goodwill is to be impaired by 10% and reprepare the Consolidated Statement of Financial Position

Other reserves

- exam questions will often give other reserves (such as a revaluation surplus) as well as retained earnings. These reserves should be treated in exactly the same way as retained earnings.

- if the reserve is pre-acquisition it forms part of the calculation of net assets at the date of acquisition and is therefore used in the goodwill calculation.

- if the reserve is post-acquisition, or there has been some movement on a reserve which existed at acquisition, the Consolidated Statement of Financial Position will show the parent entity's reserve plus its share of the movement on the subsidiary's reserve.

Mid-year acquisitions

- so far, we have considered acquisitions only at the Statement of Financial Position date. Thus, since entities produce Statements of Financial Position at that date anyway, there has been no special need to establish the net assets of the acquired entity at that date.

- with a mid-year acquisition, a Statement of Financial Position is unlikely to exist at the date of acquisition as required. Accordingly, we have to estimate the net assets at the date of acquisition using various assumptions.

- rule for mid-year acquisitions
  - assume that profits accrue evenly throughout the year unless specifically told otherwise.

Example 10

Robertas acquired 75% of the issued share capital of Ingrida on 1 August, 2009.
At 31 December, 2009 the two entities have the following Statements of Financial Position:

The directors of Robertas have valued the NCI investment on a proportional basis.

		Robertas		*Ingrida*
	$	*$*	*$*	*$*
Investment in Ingrida		15,000		-
TNCA		12,000		30,000
Other assets		13,000		4,000
		40,000		34,000
Share capital		5,000		3,000
Share premium		-		1,500
Retained earnings at 1 January, 2009	24,000		20,000	
Profit for 2009	10,000		6,000	
		34,000		26,000
		39,000		30,500
Liabilities		1,000		3,500
		40,000		34,000

Prepare the Consolidated Statement of Financial Position of the Robertas Group as at 31 December, 2009.

IFRS 13 Fair value measurement

Fair value of assets and liabilities acquired

- **the fair value is calculated as:**
  - securities and tangible non-current assets - market value
  - receivables and payables - present value
  - finished goods and work in progress - net selling price less reasonable profit margin
  - raw materials - replacement cost
  - intangible assets - by reference to an active market, or otherwise on an arm's length basis
- if the fair value of an intangible asset cannot be measured with respect to an active market, then the amount recognised should be limited to an amount that does not create negative goodwill (or if it already exists, does not increase negative goodwill).

- **method**
  - adjust assets and liabilities to reflect fair values prior to consolidation.
  - prepare the consolidated financial statements using the adjusted values of assets and liabilities.
  - consider if any adjustments are needed as a result of this eg extra depreciation.

Example 11

On 1 January 2008, Dalius acquired 70% of Ramuna for $250,000 when Ramuna's share capital and reserves were as follows:

	$'000
Share capital	130
Retained earnings	20
	150

At acquisition, the fair value of some of Ramuna's assets were greater than their book value as follows:

	$
Inventory	20,000
Non-depreciable non-current assets	15,000
Depreciable non-current assets (over 5years)	30,000
	65,000

At 31 December, 2009 the Statements of Financial Position of Dalius and Ramuna were as follows:

	Dalius	*Ramuna*
	$	*$*
Cost of investment in Ramuna	250,000	-
Other assets	350,000	300,000
	600,000	300,000
Share capital	200,000	130,000
Retained earnings	360,000	100,000
	560,000	230,000
Liabilities	40,000	70,000
	600,000	300,000

It is Dalius' policy to value the non-controlling interest on the proportionate basis

Prepare the Consolidated Statement of Financial Position of Dalius as at 31 December, 2009

Goodwill is not impaired.

Chapter 8

GROUP ACCOUNTS: INTER-ENTITY TRANSACTIONS

Issue

- the purpose of consolidation is to present the parent entity and its subsidiaries as if they existed as a single entity.
- therefore, only amounts owing to or from outside the group should be included in the Consolidated Statement of Financial Position, and any assets should be stated at cost to the group.

Trading transactions

- **inter-entity balances**
  - trading transactions will usually be recorded in current accounts in each entity's accounting records, which would also record amounts received and/or paid.
  - the current account receivable in one entity's records should equal the current account payable in the other. These two balances should be cancelled on consolidation as inter-entity receivables and payables and should not be shown.

- **reconciliation of inter-entity balances**
  - where current accounts do not agree at the year end, and in an exam they probably will not, this will be due to errors, management charges, or in-transit items such as inventory and cash.
  - for errors, make the necessary correction in the records of the entity which has made the error.
  - for management charges, make the correction in the records of the entity which has not yet accounted for the charge.
  - for in-transit items, accelerate the inventory or cash into the records of the receiving entity.

- **method**
  - make all the adjustments **ON THE FACE OF YOUR QUESTION PAPER** prior to consolidating net assets.

Example 1

Jurate acquired 70% of the share capital of Dovile on its incorporation. The Statements of Financial Position of the two entities as at 31 December, 2009 are as follows:

			Jurate		*Dovile*
			$'000		*$'000*
NON-CURRENT ASSETS					
Tangible			400		150
Investment in Dovile			140		
			540		150
CURRENT ASSETS					
Inventory		70		50	
Receivables	– Dovile	90		-	
	– other	80		70	
Cash		30		20	
			270		140
Total assets			810		290
EQUITY					
Share capital			500		200
Retained earnings			200		30
			700		230
CURRENT LIABILITIES					
Trade payables	– other	110		10	
	– Jurate	-		50	
			110		60
Total equity and liabilities			810		290

Notes:

(i) There was cash in transit of $30,000 from Dovile to Jurate at the year end.

(ii) Goods despatched by Jurate to Dovile before the year end with the related invoices to the value of $10,000 were not received by Dovile until 4 January 2010. The original cost of the goods was $10,000.

(iii) The directors of Jurate value the NCI on a proportional basis.

Prepare a Consolidated Statement of Financial Position as at 31 December, 2009.

Your question paper should now look like this, after you have made the adjustments:

			Jurate		*Dovile*
			$'000		*$'000*
NON-CURRENT ASSETS					
Tangible			400		150
Investment in Dovile			140		
			540		150
CURRENT ASSETS					
Inventory		70		50 + 10	
Receivables	- Dovile	90 - 30		-	
	- other	80		70	
Cash		30 + 30		20	
			270		150
Total assets			810		300
EQUITY					
Share capital			500		200
Retained earnings			200		30
			700		230
CURRENT LIABILITIES					
Trade payables	– other	110		10	
	– Jurate	-		50 + 10	
			110		70
Total equity and liabilities			810		300

Now cancel 60 receivable from Dovile against 60 payable to Jurate

Inventory sold at a profit within the group

- inventory should be stated at the lower of cost and net realisable value from the point of view of the group. If inventory has been transferred within the group at a profit it will be over-stated and needs to be written down.

- the entity that made the sale will have recorded a profit on the transaction which is realised from the individual entity point of view. From the group perspective, this profit will only be realised when the goods are sold to the outside world, and therefore should not be recognised in the consolidated financial statements.

- to eliminate the unrealised profit from retained earnings and inventory a provision is made in the books of the **entity making the sale**. This only happens on consolidation.

- **method**
  - calculate the unrealised profit included in inventory and note the adjustments to inventory and retained earnings **ON THE FACE OF THE QUESTION PAPER.** Both sides of the adjustment ***must*** be made to the entity which has recognised this unrealised profit ie the selling entity.

- ***Note:***

"profits" may be referred to in a number of ways. The examiner has called the profit percentage
  - a mark-up
  - a gross profit
  - a gross margin

(these last two are the same)
  - **Accept that:** Cost + Profit = Selling (or transfer) Price
  - in the exam, the examiner may give you a value for cost, or for transfer price, and will normally give you a profit percentage.
  - for mark up, the percentage relates to cost
  - for gross profit, the percentage relates to selling value.
  - so, when faced with a Provision for Unrealised Profit adjustment, always set out the equation:
  - Cost + Profit = SP
  - now put into the profit column the percentage given by the examiner.
  - next, read carefully whether this is a mark-up or a gross profit.
  - if it's mark-up, put 100 in the Cost column.
  - if it's gross profit or gross margin, put 100 in the SP column.
  - now complete the equation.
  - for example, if goods were transferred at a 20% gross margin, then the equation will appear as

C	+	Profit	=	SP
?	+	20	=	100

therefore cost must be 80

- if they were transferred at 30% mark-up, then

C	+	Profit	=	SP
100	+	30	=	?

therefore selling/transfer value must be 130

- from these equations, you can now calculate how much profit was achieved on transfer by the selling entity, and therefore also the profit element which is included in the closing inventory.

Example 2

Petras acquired 75% of the share capital of Signe on its incorporation. The Statements of Financial Position of the two entities as at 31 December, 2009 are as follows:

		Petras		*Signe*
		$'000		$'000
NON-CURRENT ASSETS				
Tangible		500		250
Investment in Signe		150		–
		650		250
CURRENT ASSETS				
Inventory	130		70	
Others	100		60	
		230		130
Total assets		880		380
EQUITY				
Equity shares		450		200
Retained earnings		300		150
		750		350
CURRENT LIABILITIES		130		30
Total equity and liabilities		880		380

Notes:

(i) there were no inter-entity balances at the year end

(ii) during December 2009 Signe sold goods to Petras for $60,000. Signe sells goods at a mark up of 25%. Petras had not sold any of these goods at the year end.

(iii) the directors of Petras value the NCI on a proportional basis.

Prepare a Consolidated Statement of Financial Position as at 31 December, 2009

Transfer of non-current assets

- **carrying value and depreciation**
  - the transfer of non-current assets at a profit within the group gives rise to the same kind of issues as the transfer of inventory, namely that the non-current assets should be stated at cost to the group and the profit on the sale is unrealised.
  - an additional problem is that the non-current asset will subsequently be being depreciated based on the new carrying value, but the group depreciation charge should be based on original cost.
  - the adjustment for unrealised profit should be made in the records of the entity which has recognised the profit ie the selling entity.
  - the adjustment for depreciation should be made in the records of the entity holding the asset.

- **method**

  make the adjustments **ON THE FACE OF THE QUESTION**:
  (1) Dr Retained earnings
  Cr Non-current assets
  with the provision for unrealised profit in the financial statements of the entity selling the asset.
  (2) Dr Non-current assets
  Cr Retained earnings
  with the surplus depreciation in the financial statements of the entity buying the asset.

Example 3

On 1 January, 2009 Linas acquired 60% of the equity share capital of Asta for $160,000 when the balance on Asta's retained earnings was $275,000. The Statements of Financial Position of the two entities at 31 December, 2009 are as follows:

	Linas *$'000*	*Asta* *$'000*
NON-CURRENT ASSETS		
Tangible	400	240
Investment in Asta	160	-
	560	240
CURRENT ASSETS	440	510
Total assets	1,000	750
EQUITY		
Equity share capital	300	120
Retained earnings	500	600
	800	720
CURRENT LIABILITIES	200	30
Total equity and liabilities	1,000	750

Note:
(i) During the year ended 31 December, 2009 Linas sold a piece of plant and equipment to Asta for $100,000. The asset originally cost $200,000 and had been written down to $80,000 as at 31 December, 2008. Both entities depreciate non-current assets on a straight line basis over 5 years, with a full year's charge in the year of purchase and none in the year of sale. Asta is depreciating the cost of the asset over its remaining useful life of 2 years.
(iii) the directors of Linas value the NCI on a proportional basis.

Prepare the Consolidated Statement of Financial Position as at 31 December, 2009.

Dividends

- **issue**
  - dividends are an appropriation of profit and the parent entity, as a shareholder of the subsidiary, will be entitled to a share of the subsidiary's dividends.
  - as always, any inter-entity payable or receivable should not appear in the Consolidated Statement of Financial Position so only the liability to third parties will be disclosed, ie the dividend payable to the non-controlling interest.

- **method**
  - adjustments will need to be made if:
    - dividends proposed before year end have not been adjusted for; and/or
    - dividends receivable still need to be accounted for in the parent entity's records.
  - the adjustments should be made **ON THE FACE OF THE QUESTION PAPER** prior to consolidation.

- ***note*:**
  - IAS 10 (revised) states that only dividends proposed before the Statement of Financial Position date should be accounted for.
  - on consolidation, the dividend receivable in the records of the parent entity will cancel out with the dividend payable in the records of the subsidiary to leave the amount payable to the non-controlling interest as a liability in the Consolidated Statement of Financial Position.
  - the adjustments are, in the parent entity records

    DR Receivables
    CR Retained earnings

    with the parent's share of the subsidiary dividend and, in the subsidiary records

    DR Retained earnings
    CR Dividends payable

    with the full subsidiary dividend.
  - then, cancel the Receivable (in parent) with the Payable (in subsidiary) leaving just the non-controlling interest's share of the dividend as a payable.

Example 4

	Laimonas *$'000*	*Kristine* *$'000*
Non-current assets		
- investment in Kristine	50	-
- other	23	16
Current assets	36	64
Total assets	109	80
Share capital	60	20
Retained earnings	40	50
	100	70
Current liabilities	9	10
Total equity and liabilities	109	80

Laimonas has proposed a dividend of $16,000
Kristine has proposed a dividend of $10,000
Both of the above were proposed before the year end, but not adjusted for.
Laimonas acquired 90% of Kristine's share capital 4 years ago when the balance on Kristine's retained earnings was $30,000.

The value of the nci shareholding at the date of acquisition was $5,500

Produce the Consolidated Statement of Financial Position of the Laimonas Group. Goodwill is impaired by 80%.

Having made the adjustments for the dividends, your question paper should look like this:

Extracts	*Laimonas* *$'000*	*Kristine* *$'000*
Receivables (Current assets)	36 +9	64
Retained earnings	40 + 9 - 16	50 - 10
Payables	9 + 16	10 + 10

Now cancel 9 receivables in Laimonas against 9 of the 10 payables in Kristine, leaving 1 payable in Kristine. In the exam, show this 1 separately as "NCI proposed dividend".

Chapter 9

GROUP ACCOUNTS: COMPREHENSIVE EXAMPLE

Example 1

Agne acquired 72% of the equity shares of Dace on 30 June 2009 for $250,000.

On 31 August 2009, the Statements of Financial Position were:

		Agne		*Dace*
		$'000		$'000
Investment in Dace		250		-
TNCA		223		270
		473		270
Inventory	50		62	
Receivables	60		48	
Cash	19		14	
		129		124
Total assets		602		394
Equity shares of $1 each		300		200
Premium		40		10
Retained earnings brought forward	150		40	
Profit for the year	60		24	
		210		64
		550		274
Long term liabilities				
3% Debentures		40		100
		590		374
Current liabilities		12		20
		602		394

1. At the date of acquisition, some of Dace's inventory had a fair value $16,000 in excess of its carrying value. All had been sold before the year end.
2. On 31 July 2009, Dace had sold an item of property, plant and equipment to Agne realising a profit on sale of $20,000. Agne was depreciating this item over its remaining useful life of 4 years. It is group policy to charge a full year's depreciation in the year of purchase, and none in the year of sale.
3. On 29 August, Agne had despatched goods to Dace at a transfer value of $26,000. Agne sells goods at a mark up of 30%. Dace had sold a quarter of these goods by the Statement of Financial Position date.
4. The current accounts did not reconcile at the year end because Dace had sent a payment of $5,000 to Agne, but Agne only received it on 3 September 2009. Before any necessary adjustment, the intra group balance in Dace's records showed an amount owing to Agne of $12,000.
5. Goodwill is impaired by 25%.
6. Both entities have declared but not yet accounted for a dividend of 5c per $1 share.
7. The directors valued the nci at $87,667 at date of acquisition

Prepare a Consolidated Statement of Financial Position for the Agne Group as at 31 August 2009.

Chapter 10

PREPARATION OF THE CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

Purpose

- **aim**
  - the aim of the Consolidated Statement of Comprehensive Income is to show the results of the group for an accounting period as if it were a single entity.
  - exactly the same principles are to be applied as for the Statement of Financial Position ie control in the first instance.
  - accordingly, we are then able to show the profits of the group arising from the control exercised by the parent entity.

- **method**
  - revenue down to profit after tax
    - AGGREGATE 100% parent and 100% subsidiary regardless of amount owned (so long as control is established) thereby showing profits controlled by the parent.
    - EXCLUDE any dividends from subsidiary since to include them would be double counting - you've included the profits out of which dividends are paid in part (i) above.
  - non-controlling interest. They want their share of this year's subsidiary profit after tax.
  - dividends – parent entity only.
  - both the non-controlling interest and the dividends should be shown in the Statement of Changes in Equity and not in the Statement of Comprehensive Income
  - retained earnings - these are calculated in exactly the same way as for the Statement of Financial Position but this time, it's only for the current year.

Example 1

Mantas acquired 80% of the issued share capital of Rochas on 1 January, 2009.
Their respective Statements of Comprehensive Income for the year ended 31 December, 2009 are as follows:

	Mantas	*Rochas*
	$	*$*
Revenue	26,000	12,000
Cost of sales and expenses	10,000	7,000
Profit from operations	16,000	5,000
Dividend from subsidiary	2,000	-
Profit before tax	18,000	5,000
Income tax expense	6,000	1,500
Profit after tax	12,000	3,500

Dividends of $5,000 and $2,500 respectively have been proposed.

Prepare the Consolidated Statement of Comprehensive Income of Mantas Group for the year ended 31 December, 2009.

(Ignore goodwill)

Strictly speaking, the Statement of Comprehensive Income should finish on the line "Profit after tax", but continue down through non-controlling interest and dividends

Inter-entity trading

- **issue**

  when considering the group as if it were a single entity, inter-entity trading represents transactions which the group undertakes with itself. Clearly these have to be eliminated from the results. The value of inventory in the Consolidated Statement of Comprehensive Income may need to be adjusted to make sure that it represents the cost to the group.

- **rules for inter-entity trading**

  - cancel inter-entity transactions from the sales and cost of sales figures, $ for $, **ON THE FACE OF THE QUESTION PAPER**
  - then account for any unrealised profit in inventory. This is always done by ADDING the pup to the cost of sales figure in the entity which has recognised the unrealised profit ie the selling entity.

Example 2

Lina acquired 60% of the issued share capital of Sigimantas on 1 January 2009. The respective Statements of Comprehensive Income for the year ended 31 December, 2009 were:

	Lina	*Sigimantas*
	$	*$*
Revenue	40,000	30,000
Cost of sales and expenses	27,000	16,000
Profit from operations	13,000	14,000
Dividend from subsidiary	3,000	-
Profit before tax	16,000	14,000
Taxation	4,800	4,200
Profit after tax	11,200	9,800

Dividends of $6,000 and $5,000 respectively have been proposed.

During the year Lina sold $4,000 worth of goods at a mark up of 25% to Sigimantas. Sigimantas had none of these goods in inventory at the year end.

Prepare a Consolidated Statement of Comprehensive Income for the Lina Group for the year ended 31 December, 2009.

Example 3

Karolis acquired 55% of the issued share capital of Irina on 1 June 2008. The respective Statements of Comprehensive Income for the year ended 31 May 2009 were:

	Karolis	*Irina*
	$	*$*
Revenue	60,000	55,000
Cost of sales and expenses	32,000	30,000
Profit from operations	28,000	25,000
Dividend from subsidiary	5,500	-
Profit before tax	33,500	25,000
Taxation	10,000	7,000
Profit after tax	23,500	18,000

Dividends of $12,000 and $10,000 respectively have been proposed.

During the year Karolis sold $14,000 worth of goods to Irina at a gross margin of 40%. One third of these goods is in Irina's inventory at the year end.

Prepare a Consolidated Statement of Comprehensive Income for the Karolis Group for the year ended 31 May 2009.

Example 4

Viktorija acquired 60% of the issued share capital of Natalija on 30 September 2008. The respective Statements of Comprehensive Income for the year ended 30 September 2009 were:

	Viktorija	*Natalija*
	$	*$*
Revenue	90,000	100,000
Cost of sales and expenses	32,000	40,000
Profit from operations	58,000	60,000
Dividend from subsidiary	12,000	-
Profit before tax	70,000	60,000
Taxation	20,000	18,000
Profit after tax	50,000	42,000

Dividends of $30,000 and $20,000 respectively have been proposed.

During the year, Natalija had sold goods to Viktorija with a transfer value of $30,000 realising a gross profit of 27%. Viktorija had sold two thirds of these goods by the year end.

Prepare a Consolidated Statement of Comprehensive Income for the Viktorija Group for the year ended 30 September 2009.

Retained earnings brought forward

Example 5

On 1 July 2001 Didzis acquired 75% of Ansis for $65,000. The balance on Ansis' retained earnings was $18,000 at that date. Ansis had equity share capital of 20,000 shares of $1 each. Goodwill had been impaired by 75%, and the Didzis' directors now wish to impair it fully.
Details for both entities for the year ended 30 June 2009 were:

		Didzis		*Ansis*
		$'000		*$'000*
Revenue		300		160
Cost of sales		192		105
Gross profit		108		55
Distribution costs	18		10	
Administrative expenses	14		17	
		32		27
Profit before tax		76		28
Income tax expense		21		16
Profit after tax		55		12
Dividends		17		8
Retained profits for the year		38		4
Retained earnings brought forward		174		37
Retained earnings carried forward		212		41

It is company policy to value the NCI as their proportionate share of the fair value of the net assets

Prepare the Consolidated Statement of Comprehensive Income of the Didzis Group for the year ended 30 June 2009, and calculate the figure for retained earnings to be shown on the Statement of Financial Position.

Rule for mid-year acquisitions

- where a parent buys a subsidiary part way through the year ie a mid-year acquisition, we are still aiming to produce financial statements which reflect CONTROL.
- clearly, the parent does not control the subsidiary results before acquisition, so we need to time apportion the subsidiary Statement of Comprehensive Income and consolidate only the post-acquisition elements.
- unless otherwise stated, assume that revenues and expenses accrue evenly throughout the 12 month period.

Example 6

Lasma acquired 90% of the issued share capital of Goda on 31 January 2009. The Statements of Comprehensive Income for the two entities for the year ended 31 August 2009 were:

	Lasma	*Goda*
	$'000	*$'000*
Revenue	15,600	2,900
Cost of sales and expenses	8,400	1,300
Profit before tax	7,200	1,600
Income tax expense	2,000	420
Profit after tax	5,200	1,180

Dividends of $1,700 and $200 respectively have been proposed, retained earnings brought forward were $6,500 and $2,020 respectively. Lasma has not accounted for dividends receivable from Goda which were proposed before the year end.

Prepare the Consolidated Statement of Comprehensive Income for the Lasma Group for the year ended 31 August 2009

Chapter 11

ACCOUNTING FOR INVESTMENTS IN ASSOCIATES (IFRS3 REVISED)

Definition of associate

- per IAS 28 (revised) an **associate** is an entity in which the investor has significant influence and which is neither a subsidiary nor a joint venture of the investor.

- **significant influence**
  - significant influence is the power to participate in the financial and operating policy decisions of the investee but is not control over those policies. Representation on the board of directors is indicative of such participation, but will neither necessarily be conclusive evidence of it nor be the only method by which the investing entity may participate in policy decisions.
  - for examination purposes the significant influence test will centre on the percentage shareholding of one entity in another.

- **IAS 28 (revised) provides that:**
  - if an investor holds directly or indirectly ≥ 20% but ≤ 50% of the voting power it is presumed the investor has the ability to exercise significant influence; therefore associate status will be presumed unless it can be demonstrated otherwise.
  - if an investor holds directly or indirectly < 20% of the voting power it is presumed the investor has no significant influence; therefore no associate status, again unless demonstrated otherwise.

- **IAS 28 (revised) states significant influence can be shown by:**
  - representation on the board of directors
  - participation in policy making processes
  - material transactions between the investor and investee
  - interchange of managerial personnel
  - provision of essential technical information

Accounting for associates in the investor's individual books

- **the investment can be**
  - carried at cost (recognising dividend income in the Statement of Comprehensive Income)
  - accounted for as an asset held for sale as described in IFRS 5
  - an asset held for sale in this case represents an investment in shares in another entity held for short-term profit-making by trading those shares. It should initially be recognised at cost and from then on at its fair value.

Consolidated financial statements

- an investment in an associate should be accounted for in consolidated financial statements using the equity method unless it can be shown that the investment is held to be disposed of in the near future or there are severe long-term restrictions on the ability to transfer funds to the investor in which case the cost method should be used.

Equity method: IFRS3 (revised) specifies the following treatment:

- **Statement of Financial Position**
  - the investment should initially be recorded at cost as a non-current asset investment. The carrying amount is increased/ decreased as follows:

Initial cost	X
Add/less: share of post acquisition retained earnings	X/(X)
Less: amounts impaired since acquisition	(X)
Carrying value	X

  - in practice, at this level, it is quicker to calculate the figure as the group's share of the associate's net assets at the Statement of Financial Position date (after accounting for dividends), but show it as a single line entry.
  - "goodwill" should be calculated in the same way as for subsidiaries and is normally (ideally) shown separately on the Statement of Financial Position.

- **Statement of Comprehensive Income**
  - the group's share of the associate's results (profit **after** tax) should be included immediately before total profit **before** tax (IAS 1).
  - the group's share of any associate prior period items should also be disclosed separately.

- ***Note***
  - an associate is not a group entity, therefore there is no cancellation of 'inter-entity' transactions. However, IFRIC 3 (International Financial Reporting Interpretations Committee) states that unrealised profits and losses on transactions between investor and associate should be eliminated (unless the unrealised loss represents an impairment) in the same way as for group accounts.
  - this elimination is best achieved by accounting for any unrealised profit ALWAYS in the associate's Statement of Comprehensive Income. It does not matter whether the goods were bought from, or sold to, the associate. ALWAYS in the associate's records.
  - remember fair values should be used when calculating net asset values and goodwill
  - uniform accounting policies should be used, or relevant adjustments must be made.
  - impairment losses should be accounted for in accordance with the principles of IAS 36

Example 1 Statement of Financial Position

Laura has a number of wholly owned subsidiaries and 35% holding of the issued share capital of Gunta which she acquired many years ago when retained earnings in Gunta were $3,000

At 31 December, 2009 the Consolidated Statement of Financial Position of Laura and its subsidiaries and the Statement of Financial Position of Gunta were as follows:

	Laura Group	*Gunta*
	$'000	*$'000*
Investment in Gunta	20	
Other assets	180	23
	200	23
Share capital	70	2
Retained earnings	115	18
	185	20
Liabilities	15	3
	200	23

Prepare the Consolidated Statement of Financial Position of the Laura Group as at 31 December, 2009, incorporating Gunta under the equity method of accounting.

Example 2 Statement of Comprehensive Income

Maris has a number of wholly owned subsidiaries and 28% holding of the issued share capital of Girts. The shares were acquired years ago. The Consolidated Statement of Comprehensive Income of Maris Group and the Statement of Comprehensive Income of Girts for the year ended 31 December, 2009 were:

	Maris	*Girts*
	$	*$*
Revenue	18,000	7,000
Cost of sales	(9,500)	(2,000)
Gross profit	8,500	5,000
Expenses	(2,900)	(1,400)
Profit from operations	5,600	3,600
Finance income	1,010	-
Finance costs	(700)	(300)
Profit before tax	5,910	3,300
Income tax	(2,000)	(1,000)
Profit after tax	3,910	2,300

Dividends of $1,500 and $400 respectively have been proposed.

Maris has not accounted for the dividend from Girts which was proposed prior to the year end.

Prepare the Consolidated Statement of Comprehensive Income for the Maris Group incorporating the results of Girts according to IFRS 3 (revised). (Ignore any goodwill).

Chapter 12

IAS 2 INVENTORIES

- accruals concept requires revenues and associated costs to be matched
- so cost of inventory in hand at the end of the year should be deducted in arriving at cost of sales for the year

- **inventory comprises:**
  - raw material
  - production supplies
  - work in progress
  - finished goods
  - goods in saleable condition
- valuation of closing inventory
  - at the lower of cost and net realisable value
- cost includes all those costs incurred in bringing the inventory to its present location and condition including purchase cost, conversion cost and other costs (see next)
- in determining lower of cost and net realisable value each line of inventory should be considered separately

- **purchase cost comprises:**
  - purchase price
  - import duties and other taxes
  - carriage inwards
  - but excludes trade discounts, rebates and similar deductions

- **conversion costs comprise:**
  - costs directly related to units of production eg direct labour, direct expenses and sub-contract costs
  - systematic allocation of fixed and variable production overheads incurred in converting materials into finished goods
  - fixed production overheads are allocated on the basis of normal activity
  - in periods of abnormally high activity, fixed overhead allocation per unit should be reduced to avoid over valuation of inventory
- other costs are included to the extent they are incurred in bringing inventory to its present location and condition
- **determining cost may be achieved in a number of ways:**
  - actual cost (of identifiable items eg used cars)
  - FIFO
  - weighted average cost (total cost of units purchased divided by total number of units purchased) the price is recalculated each time more units are purchased
  - standard cost
  - retail method – simply, sales value less an appropriate gross margin
  - replacement cost – used where an active market exists. Not unusual in valuing commodities such as gold
  - LIFO – however, no longer recognised as acceptable
- benchmark is either FIFO or weighted average cost but, in the interests of truth and fairness, any method may be used.
- **NRV may be less than cost in a number of possible situations:**
  - an increase in costs or a decrease in selling price
  - inventory is no longer in best physical condition
  - finished inventory is now technically obsolete or out of fashion
  - a strategic management decision to sell goods at less than cost
  - errors made in purchasing or production
- **disclosure**
  - accounting policy used in measuring inventory including the cost formula
  - total carrying amount in inventory, appropriately classified
  - amount of inventory held at net realisable value
  - amount of any reversals of previous write-downs and circumstances which caused the reversal
  - carrying amount of any inventory promised as security for debt

Chapter 13

IAS 11 CONSTRUCTION CONTRACTS

- prudence dictates no recognition of profit until actually realised
- but this would lead to MAJOR distortion of profit figures
- so IAS requires the spreading of profit over the life of a construction contract
- **construction contract** is a contract specifically negotiated for the construction of an asset or a combination of assets that are closely interrelated or interdependent in terms of their design, technology and function or their ultimate purpose or use eg building a bridge, building, dam, ship.
- a construction contract need not be one which takes more than 12 months, but is one which affects more than one accounting period.
- two types – fixed price contract and cost plus contract
- one contract, multiple units? Treat as separate contracts if:
  - separate proposals have been submitted for each unit
  - costs and revenues can be separately allocated
  - an example: one contract, four power stations
- group of contracts, but treated as one single contract?
  - group of contracts negotiated as a single package
  - contracts so closely interrelated that they appear to be one
  - contracts are performed at the same time
  - an example: fifty contracts to build fifty houses (one in each contract)

- **contract revenue comprises:**
  - initial amount of revenue agreed in the contract
  - agreed variations in contract work, claims and incentives…
  - … but only to the extent that revenue will probably result, and
  - … these revenues are capable of reliable measurement

Example 1

Tomas has been asked by Iveta to build an apartment block in Kaunas. The project will take 4 years. Iveta has agreed to pay the following:

(1) $ 1 million for the apartment block
(2) $300,000 extra if the block is at least 60% complete by the end of year 2
(3) a bonus of $100,000 if Iveta is pleased with the finished block

(a) At the end of year 1, how much of the total contract revenue should be recognised?

(b) At the end of year 2, what options would you have?

- **contract costs comprise:**
  - costs directly related to the contract
  - costs attributable generally to contract activity and which can be allocated to the contract
  - such other costs specifically chargeable to the customer under the terms of the contract
- recognition of revenues and costs according to stage reached
- in the exam, the examiner will either tell you a percentage stage reached or will give you a basis for its calculation
- it may be, for example, costs to date as a percentage of total costs in the contract, or…
- …valuation of work certified as a percentage of the contract price
- **accounting treatment**
  - recognise as revenue the appropriate percentage of the contract value
  - recognise as expense the same percentage of total costs of the contract unless…
  - … an overall loss is forecast, in which case recognise the forecast loss in full.
- NB no profit is recognised until the contract is sufficiently advanced to be able to predict with reasonable certainty the ultimate outcome

Three workings required

- **W1 Statement of comprehensive income**

Revenue recognised, say 60% x contract price	X
Costs recognised	
100% x period specific	(X)
60% x other general costs	(X)
∴ Profit recognised	X

- **W2 Statement of financial position**

Costs to date	X
Attributable profits (W1)	X
	X
Less amount invoiced	(X)
Amounts due from customers	X

- **W3 Statement of financial position**

Amounts invoiced	X
Less amounts received	(X)
Amounts due from customers	X

Example 2

	$
Total contract price	1,000,000
Costs incurred to date	400,000
Estimated costs to complete	350,000
Percentage complete	55%
Amounts invoiced	500,000
Amounts received	470,000

Prepare relevant extracts from the Statement of Comprehensive Income and Statement of Financial Position.

Progress billings in excess of gross amounts due from customers

- if the amount received or receivable on a contract is in excess of the 'gross amounts due from customers' (contract costs incurred and recognised profit) then the excess should be shown in payables and separately disclosed as 'amounts due to customers'.

- this is a presentation point only.

Example 3

	$
Total contract price	1,200,000
Costs incurred to date, including 200,000 relating to this year	750,000
Estimated costs to complete	300,000
Amounts invoiced	790,000
Amounts received	700,000
Percentage complete	60%

Prepare relevant extracts from the Statement of Comprehensive Income and Statement of Financial Position.

Expected losses

- losses should be accounted for in full as soon as they are foreseen.

- these are losses currently estimated to arise over the duration of the contract. This estimate is required irrespective of:
  - whether or not work has yet commenced on the contract
  - the stage of completion of contract activity
  - the amount of profits expected to arise on other contracts.

Example 4

	$
Total contract price	500,000
Costs incurred to date	300,000
Estimated costs to completion	250,000
Amounts invoiced	270,000
Amounts received	240,000
Percentage complete	65%

Prepare relevant extracts from the Statement of Comprehensive Income and Statement of Financial Position.

- an exam question may give you data for more than one year for a particular contract. In this case, the Statement of Financial Position workings still apply for each year.

- but the Statement of Comprehensive Income revenue and cost recognition is cumulative, so only the difference from one year to the next is recognised.

Example 5

	Year 1	*Year 2*	*Year 3*
	$	$	$
Contract value	1,000,000	1,000,000	1,200,000
Costs to date, general	300,000	500,000	800,000
Specific to date	40,000	40,000	190,000
Estimated to complete	500,000	600,000	-
Amounts invoiced	390,000	610,000	1,150,000
Amounts received	400,000	630,000	1,100,000
Percentage complete	30%	65%	100%

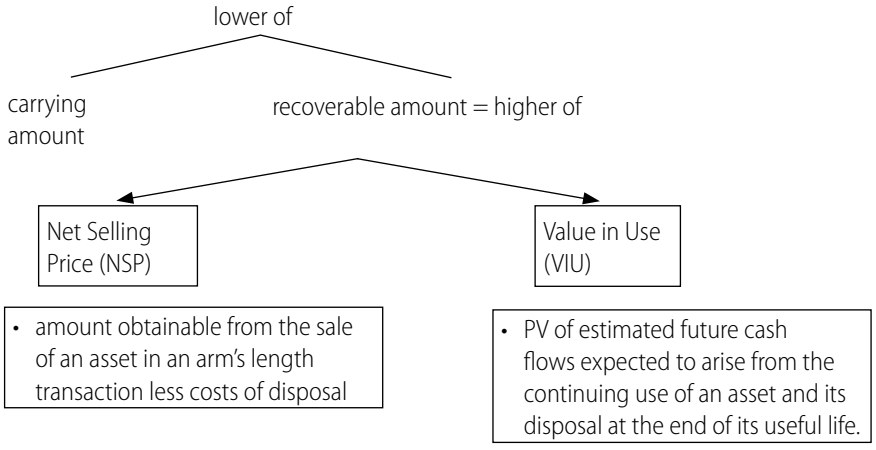
The additional $200,000 contract value arose in year 3 from an agreed variation with the customer as a result of customer's delays involving additional costs for the constructor of $150,000, none of which was foreseen at the end of year 2.

Prepare relevant extracts from the Statements of Comprehensive Income and Statements of Financial Position for each of the 3 years.

Chapter 14

IAS 36 IMPAIRMENT OF ASSETS

- entities should assess at the year end whether there is any indication that any of their assets is impaired
- indicators may be external or internal
- **external indicators may include:**
  - significant decline in market value
  - adverse changes in the environment in which the entity operates whether technological, market, economic or legal
  - increase in market interest rates or market rates of return
  - carrying amount of net assets exceeds market capitalisation
- **internal indicators may include**
  - theft
  - obsolescence or physical damage
  - evidence that asset performance is worse than expected
  - management's plans to restructure or dispose of the asset earlier than originally planned
- assets should be measured at the lower of carrying amount and recoverable amount



- if recoverable amount for an individual asset is not measurable, then entity should determine the recoverable amount of the cash generating unit to which it belongs

- **Cash-Generating Units (CGUs)**
  - a cash-generating unit is the smallest identifiable group of assets that generates cash inflows from continuing use that are largely independent of the cash inflows of other assets or groups of assets.
  - goodwill and corporate assets (such as head office assets) that relate to, and can be allocated on a reasonable and consistent basis to, the CGU should be considered when determining carrying amount and recoverable amount.

Calculation of value in use

- cash inflows and outflows should be estimated for assets or CGUs from continuing use of the asset in their current condition including:
  - directly attributable cash flows;
  - an appropriate proportion of cash flows that can be allocated on a reasonable and consistent basis to the asset or CGU; and
  - any net cash flows to be received or paid for the disposal of the asset at the end of its useful life on a fair value basis.
- they should not include estimated cash inflows or outflows from:
  - a future restructuring to which the entity is not yet committed; nor
  - future capital expenditure that will improve the asset or CGU in excess of its originally assessed standard of performance; nor
  - financing activities; nor
  - income tax receipts or payments.

Discount rate for value in use calculation

- the discount rate should be a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the asset.

Impairment losses treatment

- first, individually impaired assets
- then goodwill in the cgu
- then the excess allocated on a proportional basis against the other cgu assets but …
- … no asset should be impaired to an amount less than its recoverable amount

Accounting treatment of impaired losses:

- if asset held at a revalued amount, then reduce revaluation account
- if asset held at depreciated historic cost, then reduce value through the statement of comprehensive income
- after the recognition of an impairment, depreciation or amortisation should be based on the impaired value over the remaining estimated useful life
- unusually, an impairment may be reversed
- accounting treatment is the reverse of the treatment applied on the impairment
- but don't unimpair to a value greater than the asset would have been valued if it had not been impaired in the first place
- where there is a cgu impairment reversal, the question arises as to whether goodwill impairment should be reversed
- only in VERY EXCEPTIONAL circumstances should goodwill be reversed
- **disclosure**
  - amount of impairment losses recognised in the statement of comprehensive income and the assets affected
  - similarly the amount of impairment reversals
  - amount of impairment losses (reversals) taken directly to equity
- **for material impairment losses (and reversals)**
  - events and circumstances
  - amount
  - asset involved, or cgu
  - for initial losses, whether recoverable amount is viu or nsp, together with details of discount rate or selling price as appropriate

Chapter 15

IAS 37 PROVISIONS, CONTINGENT LIABILITIES AND CONTINGENT ASSETS

- a provision is a liability that is of uncertain timing or amount
- objective of IAS 37 is to set out principles of accounting for provisions and contingencies
- also to ensure appropriate recognition criteria and measurement bases are applied …
- … and that sufficient information is disclosed in the notes to enable users to understand their nature, timing and amount
- **recognition of a provision:**
  - when an entity has a present obligation
  - legal or constructive
  - as a result of some past event
  - involving the probable outflow of economic resource to settle the obligation
  - capable of reliable measurement
- provisions should be reviewed each year and adjusted to reflect best estimate

IAS 37 – Obligating events and onerous contracts

- an obligating event is a past event which has led to a present obligation
- to be classed as an obligating event it is necessary that the entity has no realistic alternative to settling the obligation created by the event
- legal obligations arise from contract, from legislation or from other operation of law
- constructive obligations arise when the entity has established a pattern of best practice, or published policies, or has indicated by specific statement that it will accept certain responsibilities and …
- … has therefore created a valid expectation in the minds of those affected
- provisions for future operating losses should not be recognised (they don't meet the definition of a liability)
- onerous contracts? One which the entity would prefer not to be involved with because, whatever they do, there will be an outflow of economic resource
- provision should be made for that outflow to the extent of the least amount which could be lost

Example 1

Daiva has a contract to buy 900 metres of cloth each month for $7 per metre. From each 3 metres of cloth she can make a dress which she can sell for $30. She also incurs labour costs of $4 per dress. Alternatively she can sell the cloth immediately for $6.25 per metre.

If she decides to cancel the cloth purchase contract without notice she must pay a cancellation penalty of $700, for each of the next two months.

In December 2009 the market price of dresses fell to $22.
She is considering ceasing production since she believes that the market will not improve.
There is 2 months notice stated in the contract in case of breach of a contract.

(a) Is there a present obligation?

(b) What will appear in respect of the contract in Daiva's financial statements for the year ending 31 December, 2009.

IAS 37 – Restructuring issues

- restructuring costs should be provided for only when the entity has an obligation (legal or constructive)
- such obligation arises only when the entity has:
  - a detailed formal plan for restructuring and …
  - … has raised the valid expectation in the minds of those affected that it will go ahead with the plan

- this may be by commencing action under the plan or …
- …by announcing the main features to those affected by it

Example 2

On 18 August 2009 the directors of Paulius decided to close the Kaunas Factory

(a) Assuming that no steps were taken to implement the decision and the decision was not communicated to any of those affected by the Statement of Financial Position date of 31 August, 2009 what is the appropriate accounting treatment?

(b) What would be the appropriate accounting treatment for the closure if a detailed plan had been agreed by the board on 26 August 2009, and letters sent to notify suppliers? The workforce in Kaunas has been sent redundancy notices.

Provisions

- provision for restructuring costs should include only expenditure directly arising from the restructuring and which are:
  - necessarily incurred by the restructuring and …
  - not associated with the ongoing activities of the entity

Disclosure for provisions

- brief description of the obligation
- expected timing of economic outflow
- indication of uncertainties re amount or timing of outflow
- amount of any expected reimbursement

Contingent liabilities are either:

- possible obligations arising from some past event, the existence of which will be confirmed only on the occurrence or non-occurrence of some substantially uncertain future event not wholly within the control of the entity, or…

- ...a present obligation which is not recognised because either:
  - the amount involved cannot be reliably measured, or …
  - ...it is not probable that there will be an outflow of economic resource to settle the obligation

Contingent liability disclosure:

- nature of the contingent liability
- estimate of its financial effect
- indications of uncertainties re amount or timing of outflow
- possibility of any reimbursement

Example 3

Justina supplies fish to a local restaurant. In August 2009 she supplied the restaurant with some shell-fish, and now she has heard that some of the restaurant's customers have suffered attacks of food-poisoning. The restaurant has claimed that this is because of Justina's shell-fish, and has commenced a legal action against her.

Algirdas, a local solicitor who specialises in food-poisoning cases, has advised Justina that she has a 42% chance of losing the case, and that, if she does lose, she will probably have to pay $300,000 to settle the liability.

What is the nature of Justina's liability, if any, and how should it be treated in her financial statements for the year ended 31 August, 2009?

Contingent assets

- Contingent assets are possible assets arising from past events whose existence will only be confirmed by the occurrence or non-occurrence of some substantially uncertain future event not wholly within the control of the entity
- entities should not recognise contingent assets – it could result in the recognition of profits which may never be realised
- however, if realisation of profit is virtually certain, then the asset is no longer contingent and should be recognised

Contingent asset disclosure:

- nature of the asset
- estimate of financial effect, if practicable

IAS 37 – additional issues

- entity may be jointly and severally liable for an obligation
- if so, provide/recognise the extent of the entity's own liability
- and disclose the contingent liability which the entity may face where others should pay but possibly do not
- aggregation into a class of provisions or contingencies?
  - where items are sufficiently similar, for example warranties, then OK
  - but not appropriate to aggregate, for example, warranties with a provision in respect of a legal action
- continual review should be carried out – contingencies will change over time – to determine continuing appropriateness of accounting treatment
- where probability changes during an accounting period the adjustment necessary will be reflected in the financial statements for the period in which it changed
- reimbursement may be sought from another party. If so …
  - …recognise a provision for the full amount and …
  - …disclose the potential reimbursement by way of note

Summary in table form

Probability of outcome	*Assets*	*Liabilities*
Virtually certain	Recognise	Recognise as a provision *
Probable	Disclose as a contingent asset	Recognise as a provision *
Possible	Ignore	Disclose as a contingent liability
Remote	Ignore	Ignore

* if the probable liability is not capable of reliable measurement, or will probably not involve the outflow of economic resource, then treat it as a disclosable contingent liability.

Example 4

Ginta, an Australian mining business, was fined $130,000 by the Lithuanian government for polluting the River Nerys. The Seimas is about to pass new legislation which will require Australian miners to clear up their mining sites, and to change their mining processes in order to avoid a repetition of the river pollution incident.

Advise Ginta of the correct accounting treatment in her financial statements for the year ended 31 December, 2009 of

(a) the $130,000 fine

(b) the costs of clearing up her mining sites

(c) the costs of changing her mining processes

Chapter 16

IAS 17 LEASES

- the classic example of the issue "substance over form"

- **definitions**
  - a ***finance lease*** is a lease that transfers substantially all the risks and rewards of ownership of an asset (to the lessee). Title may or may not be eventually transferred.
  - the ***lease term*** is the non-cancellable period for which the lessee has contracted to lease the asset together with any further terms for which the lessee has the option to continue to lease the asset, with or without further payment, which option at the inception of the lease it is reasonably certain that the lessee will exercise.
  - the ***minimum lease payments*** are the payments over the lease term that the lessee is, or can be, required to make excluding contingent rent, costs for services and taxes to be paid by and reimbursed to the lessor, together with any amounts guaranteed by the lessee or related party.
  - ***fair value*** is the amount for which an asset could be exchanged or a liability settled between knowledgeable, willing parties in an arm's length transaction.
  - ***interest rate implicit in the lease*** - the discount rate that, at the inception of a lease, causes the aggregate present value of the minimum lease payments and the unguaranteed residual value to be equal to the fair value of the leased asset.

IAS 17 – accounting treatment for finance leases

- on signing a finance lease

  Dr TNCA

  Cr Obligations account

  with the lower of fair value and minimum lease payments

- **note**

  the only obligation recognised is the capital element of the lease. The interest element is not yet an obligation

- as instalments are paid, each instalment will repay some of the obligation but also includes an element of finance lease interest

- the interest element will be charged in the statement of comprehensive income each year within finance costs

- **problem!**

  how to calculate the interest relating to each individual accounting period affected by the lease?

- **three possible ways (at least!!)**
  - straight line / level spread method – ugh
  - sum of the digits method – ok
  - actuarial method – ideal

- the actuarial method uses the interest rate implicit in the lease to calculate the finance charge for each period based on the amount of obligation outstanding

- in the exam, the examiner will (hopefully!) give you the implicit interest rate

- **recording the finance charge**

Dr	Finance cost (as calculated) (Statement of Comprehensive Income)		X	
	Cr	Accruals		X

- **paying the instalments**

Dr	Obligations under finance lease account (capital element)		X	
Dr	Accruals (finance charge element)		X	
	Cr	Cash		X

Note: the instalment covers both capital and the finance charge.

- **depreciating the asset**

depreciation must be provided on the asset. If there is no reasonable certainty that the lessee will obtain ownership by the end of the lease term, the asset should be fully depreciated over the shorter of the:
(a) lease term
(b) useful life of the asset.

Dr	Depreciation (Statement of Comprehensive Income)		X	
	Cr	Accumulated depreciation (Statement of Financial Position)		X

- if there is reasonable certainty that the lessee will obtain ownership by the end of the lease term (eg a hire purchase contract) then the asset should be depreciated over its estimated useful life.

Disclosures

- **Statement of Financial Position**
  - *non-current assets*
    - included in the net book value of property, plant and equipment is $y in respect of assets held under finance leases.
  - the balance remaining at the year end needs to be split between current liabilities and non-current liabilities
  - *non-current liabilities*

Obligations under finance leases	X

  - *current liabilities*

Obligations under finance leases	X
Accruals - interest accrued to SoFP date, not yet paid	X

  - obligations under finance leases: reconciliation of minimum lease payments and present value

	$	
Within one year	X	(gross)
Later than one year and not later than five years	X	(gross)
Later than five years	X	(gross)
Less finance lease interest, not yet accrued	(X)	
Present value of obligations under finance leases	X	

	$	
Within one year	X	(net)
Later than one year and not later than five years	X	(net)
Later than five years	X	(net)
Present value of obligations under finance leases	X	

  - ***Note:*** the minimum lease payments include the finance lease interest element. The present value is the capital element only of the lease liability.

- **Statement of Comprehensive Income**
  - Although not specifically required by IAS 17 (revised) entities tend also to disclose the following in the notes to the financial statements:

	$
Finance cost	
Finance lease interest	X
Depreciation on assets held under finance leases	X

Example 1

Sergijus acquires an asset on 1 January, 2009 which has a fair value of $17,500 on a lease the terms of which are that he pays a deposit of $460 followed by seven annual instalments of $3,500 payable in arrears.

Calculate the interest charge for each year using the actuarial method. The interest rate implicit in the lease is 10%.

Example 2

Giedris acquires an asset on 1 January, 2009 under a finance lease under the following terms:

Fair value:	16,000
Instalments:	14 @ 1,500
Estimated useful life:	9 years
Dates of payment:	30 June and 31 December each year

Giedris is required to pay a deposit of 1,152 on 1 January, 2009.
On the same day Giedruola bought a similar asset under a finance lease with the same terms, except that her dates of payment were 1 January and 1 July each year.
Giedruola is required to pay a deposit of 1,910. This amount includes the sum of 1,500 due on 1 January, 2009.

Prepare relevant extracts from the financial statements for Giedris and Giedruola for the year ended 31 December, 2009 assuming a rate of interest 10%.

Operating leases

- **operating lease** is any lease other than a finance lease.
- **accounting treatment**
  - rentals should be recognised as an expense in the Statement of Comprehensive Income on a straight-line basis over the lease term unless some other systematic basis is representative of the time pattern of the user's benefit
- **disclosure**
  - the future minimum lease payments under non-cancellable operating leases are as follows:

	$
Within one year	X
Later than one year and not later than 5 years	X
Later than five years	X
	X

- ***Note:***

  the above disclosure is made to provide information about future liabilities. It does not analyse any figure included in the financial statements.

- where land and buildings are leased, the land element will be an operating lease, and the buildings element may be either an operating or a finance lease.

IFRIC 4 – another recent look at leases

- draftsmen continue to try to find ways of creating arrangements which lie outside the "normal" leasing type contracts.
- nevertheless, these arrangements could realistically be seen as finance leases
- examples in IFRIC 4 include
  - outsourcing arrangements
  - telecommunication contracts that provide rights to capacity
  - take-or-pay and similar contracts, in which purchasers must make specified payments regardless of whether they take delivery of the contracted products or services.

IFRIC 4 specifies that such an arrangement is, or contains, a lease that should be accounted for in accordance with IAS 17 Leases if it meets the following criteria:

- fulfilment of the arrangement depends upon a specific asset (specified or not-specified). An asset may be unspecified in the situation where only one particular asset is capable of doing the job. Therefore, there is no need to specify that it is an (eg) ZX492D
- the arrangement transfers a right to control the use of the asset.
- this will be so if any of the following conditions is met:
  - the "purchaser" in the arrangement has the ability or right to operate the asset or direct others to operate the asset and at the same time can enjoy a significant amount of the output of the asset
  - the "purchaser" has the ability or right to control physical access to the asset and at the same time can enjoy a significant amount of the output of the asset
  - there is only a remote possibility that parties other than the "purchaser" will take a significant amount of the output of the asset and the price that the "purchaser" will pay is neither fixed based on levels of output nor equal to the current market price at the time of delivery.

Chapter 17

IAS 23 BORROWING COSTS

- qualifying loan is a loan borrowed to finance the construction, acquisition or production of a qualifying asset
- qualifying asset is an asset that necessarily takes a substantial period of time to be ready for its intended use or sale
- borrowing costs relating directly to qualifying loans must be capitalised as part of the cost of the qualifying asset
- where funds are borrowed specifically for the qualifying asset, should capitalise borrowing costs less any investment income earned from the temporary investment of surplus funds
- where funds are borrowed generally, should capitalise an appropriate proportion of borrowing costs, calculated on a weighted average basis
- where the carrying value of the qualifying asset exceeds its recoverable amount, should be impaired
- **commencement of capitalisation:**
  - expenditure on qualifying asset has begun, and …
  - … borrowing costs are being incurred, and …
  - … activities are in progress to prepare the asset for its intended use or sale
- borrowing costs should not be capitalised when incurred during extended periods of inactivity
- capitalisation should cease when substantially all activities necessary to prepare the asset are complete

- **disclosure**
  - accounting policy
  - amount of borrowing costs capitalised during the period
  - capitalisation rate used to determine the amount of borrowing costs eligible for capitalisation

Example 1

Edigijus has arranged a loan with Swedbank to enable him to build a new football stadium in Vilnius. He will be allowed to borrow up to $300,000,000 to be used in such amounts and at such times as he requires the funds. The bank charges interest at the rate of 7% per annum, and Edigijus is able to invest any surplus funds at the rate of 5% per annum.

He borrowed $100,000,000 on 1 January 2008, and immediately invested $50,000,000. On 28 February he withdrew $30,000,000. On 1 April he borrowed a further $120,000,000 of which he invested $70,000,000. On 31 May, he spent $60,000,000. On 31 August he borrowed a further $80,000,000 and spent $20,000,000 immediately. On 1 November work was stopped because of a strike by the workforce. The work recommenced on 1 January, 2009, and Edigijus spent the rest of the loan in completing the project, which was ready for final inspection by 28 February. The local authority finally gave their approval of the stadium on 1 April, and paid Edigijus the full contract price of $350,000,000.

Calculate the carrying amount in Edigijus' financial statements immediately before the sale transaction.

Chapter 18

IAS 12 INCOME TAXES

- current tax should normally be recognised in the statement of comprehensive income except when…
- ...it relates to a gain or loss which has been recognised initially in equity
- dividend income (and interest and other similar income) should be grossed up for withholding tax and…
- ...the tax charge for the year should be correspondingly increased
- income and expenses included in arriving at profit before tax are included on an accruals basis
- current tax should be calculated using tax rates and laws which have been enacted (or substantially enacted) by the date of the statement of financial position
- tax charge in the statement of comprehensive income often bears little relationship to the profit before tax figure in the statement of comprehensive income
- profit before tax figure is adjusted to bring it into line with tax rules (as distinct from accounting rules)
- the differences between these two sets of rules may be permanent differences or temporary differences

IAS 12 differences in greater detail and deferred tax

- permanent differences arise where certain items included within the statement of comprehensive income are either not taxable or not allowable for tax
- an example – entertaining expenditure
- temporary differences arise where there are differences between the carrying value of assets or liabilities in the statement of financial position compared with their value for tax purposes (their tax base or tax written-down value)
- deferred tax is the tax attributable to these temporary differences
- temporary differences may be taxable or deductible
- taxable temporary differences give rise to a deferred tax liability payable in the future
- deductible temporary differences give rise to a deferred tax asset in the future.

IAS 12 Temporary differences

- taxable temporary differences can be short-term differences or long-term differences, for example arising on the revaluation of assets
- timing differences arise where financial statements items are taxable, but are recognised for tax reasons in periods other than the financial statements period
- for example, interest received is included in financial statements on an accruals basis but …
- … for tax purposes it is recognised on a cash / receipts basis
- the temporary difference is the difference between interest recognised in the statement of comprehensive income and interest actually received

Example 1 - Royalty income

Jurgita's profit from operations before royalty income is $700,000 per annum. In 2009 she was entitled to a one off royalty receipt of $60,000, which she eventually received in 2010.
Income tax is 25%
Extracts from Statement of Comprehensive Income

	2009	*2010*
	$'000	*$'000*
Profit from operations	700	700
Royalty receivable	60	-
	760	700
Income tax @ 25% on taxable profits	(175)	(190)
Profit after tax	585	510

Taxable profits

	$'000	*$'000*
Profit from operations	700	700
Royalty received	-	60
	700	760
Income tax @ 25%	175	190

Show how the entity provides for deferred tax on the temporary timing difference.

IAS 12 Temporary differences continued

- a temporary difference also arises where the capital allowances rate (or tax depreciation rate) differs from the accounting deprecation rate applied to the same asset

Example 2

Andris buys an asset on 1 January, 2009 for $600,000.
It has a useful life of three years and is scrapped at the end of its life.

	2009	*2010*	*2011*
	$'000	*$'000*	*$'000*
Profits before depreciation	1,800	2,300	2,500

A first year tax allowance of 100% is available on this asset.
The tax rate for Andris is 25%

Show how Andris should provide for deferred tax on the temporary timing difference.

- another time that temporary difference arises is following a revaluation of asset
- the difference is the difference between the asset's revalued amount and its tax written-down value
- because the revaluation increase is credited direct to equity, the associated deferred tax should also be charged to equity, and therefore is not included as part of the tax charge for the year in the statement of comprehensive income

Example 3

Aija purchased a property on 1 January 1998 for $450,000. On 31 December, 2009 the property has a net book value of $342,000 and was revalued to $600,000. The tax written down value was $450,000.
Income tax rate is 25%

Calculate the figure for the Revaluation Reserve as at 31 December, 2009.

IAS 12 deductible temporary differences

- less common than taxable temporary differences
- give rise to a deferred tax asset on the statement of financial position

Example 4

Ilze has a profit from operations of $660,000 per annum (before warranty payments). In 2009 she recognises a liability of $160,000 for accrued product warranty costs. For tax purposes the warranties will not be deductible until the entity pays them. $160,000 of claims are paid in 2010
Income tax is 25%

Extracts from Statement of Comprehensive Income

	2009	*2010*
	$'000	*$'000*
Profit from operations	660	660
Warranties	(160)	-
	500	660
Income tax @ 25% on taxable profits	165	125
Profit after tax	335	535

Taxable profits

Profit from operations	660	660
Warranty payments made	-	(160)
	660	500
Income tax @ 25%	165	125

The entity wishes to provide for deferred tax on the temporary difference.

- IAS 12 requires the use of the "full provision" method whereby temporary differences are provided for in full
- based on the principle that the financial statements for a period should recognise the tax effects of all transactions occurring in that period
- deferred tax assets and liabilities should be calculated using tax rates which are expected to apply in the period when the asset is realised or the liability is settled
- two alternative bases have previously been followed:
  - flow-through, and
  - partial provision
- flow-through based on the principle that only the tax applicable to the accounting period should be recognised – so no deferred provision is made
- partial provision based on the principle that deferred tax should only be accounted for to the extent that the differences will reverse in the foreseeable future and will not be replaced

Reasons for recognising deferred tax and related disclosure requirements

- **reasons for recognising deferred tax:**
  - accruals concept requires it
  - deferred tax will become a liability eventually
  - if not recognised, overstatement of profit could lead to:
    - over-optimistic dividend payments
    - distorted earnings per share figure (and P/E ratio) will mislead stake-holders
    - share-holders will be under-informed
- **disclosure**
  - masses of disclosure requirements include:
    - current tax expense
    - adjustments recognised this year to the tax charges from previous periods
    - tax relating to items charged direct to equity
    - details of deferred tax asset / liability broken down by type of temporary difference
    - reconciliation between accounting profit and taxable profit

Chapter 19

IAS 7 (REVISED): STATEMENTS OF CASH FLOWS

Purpose

- the purpose is to show the effect of an entity's commercial transactions on its cash balance.
- it is thought that users of financial statements can readily understand cash flows, as opposed to Statements of Comprehensive Income and Statements of Financial Position which are capable of manipulation by the use of different accounting policies and creative accounting.
- cash flows are used in investment appraisal methods such as net present value and therefore a Statement of Cash Flows gives potential investors a better chance to consider the performance of a business.
- IAS 7 (revised) Statements of Cash Flows separates cash flows into the following headings:
  - Cash flow from operating activities
  - Cash flow from investing activities
  - Cash flow from financing activities
- cash comprises cash in hand and demand deposits
- cash equivalents are short-term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value.
- ready conversion is normally taken to mean convertible into cash within 3 months after the Statement of Financial Position date.

An Entity

- **Statement of Cash Flows (INDIRECT METHOD) for the year ended 31 December, 2009**

	$ '000	*$ '000*
Cash flows from operating activities		
Net profit before taxation	8,900	
Adjustments for:		
Depreciation	1,200	
Investment income	(700)	
Interest expense	900	
Operating profit before working capital changes	10,300	
Decrease in inventories	2,700	
Increase in trade and other receivables	(800)	
Decrease in trade payables	(2,300)	
Cash generated from operations	9,900	
Interest paid	(1,000)	
Income taxes paid	(3,400)	
Dividends paid*	(3,000)	
Net cash flow from operating activities		2,500
Cash flows from investing activities		
Purchase of property, plant and equipment	(1,700)	
Proceeds from sale of property, plant and equipment	300	
Interest received	400	
Dividends received	600	
Net cash flow from investing activities		(400)
Cash flows from financing activities		
Proceeds from issue of share capital	3,600	
Proceeds from long-term borrowings	2,800	
Payment of finance lease liabilities	(2,900)	
Net cash from financing activities		3,500
Net increase in cash and cash equivalents		5,600
Cash and cash equivalents at beginning of year (Note)		(1,700)
Cash and cash equivalents at end of year (Note)		3,900

* This may alternatively be shown as a cash flow from financing activities.

- ***Note 1:*** Property, plant and equipment

  During the year, the entity acquired property, plant and equipment with an aggregate cost of $2,600,000 of which $900,000 was acquired under finance leases. Cash payments of $1,700,000 were made to purchase property, plant and equipment.

- ***Note 2:*** Cash and cash equivalents

  Cash and cash equivalents consist of cash in hand and balances with banks, and investments in the money market. Cash and cash equivalents included in the Statement of Cash Flows comprise the following Statement of Financial Position amounts:

	2009	*2008*
	$m	*$m*
Cash in hand and balances with banks	400	(1,800)
Short-term investments	3,500	100
Cash and cash equivalents	3,900	(1,700)

The entity has further borrowing facilities of $2,000 of which only $700 may be used for future expansion.

- **operating activities**
  - cash flows from operating activities are primarily derived from the principal revenue-producing activities of the entity. Therefore they generally result from the transactions or other events that enter into the determination of net profit or loss.
  - the amount of cash flows arising from operating activities is a key indicator of the extent to which the operations of the entity have generated sufficient cash flows to repay loans, maintain the operating capacity of the entity, pay dividends and make new investments without relying on external sources of finance.

- **investing activities**
  - the cash flows included in this section are those related to the acquisition or disposal of any non-current assets, or trade investments. This section shows the extent of new investment in assets which will hopefully generate future profit and cash flows.

Example 1

On 31 December, 2008 the carrying value of property, plant and equipment in the records of Danguole was:

	$
Property, plant and equipment at cost or valuation	960,000
Accumulated depreciation	390,000
Property, plant and equipment at net book value	570,000

On 1 January, 2009 an item of plant was sold for $47,000 which had originally cost $110,000 when new, and had a net book value of $40,000 at the time of sale.
During 2009, property with a carrying value of $100,000 was revalued to $350,000.
On 31 December, 2009 the value of property, plant and equipment in the Statement of Financial Position was:

	$
Property, plant and equipment at cost	1,320,000
Accumulated depreciation	520,000
Property, plant and equipment at net book value	800,000

Show the relevant entries for property, plant and equipment which would appear in the Statement of Cash Flows for the year ended 31 December, 2009 for Danguole.

- **financing activities**
  - cash flows in this section relate to the way the entity has increased or decreased its capital base by way of share issues or borrowings or by repaying loans and obligations under finance leases.
  - financing cash flows comprise receipts from or repayments to external providers of finance in respect of principal amounts of finance. In order to calculate such figures the closing Statement of Financial Position figure for long term debt or share capital is compared with the opening position for the same items.
  - the effects of any non-cash flow changes to share capital (eg bonus issues) must also be taken into account. Finance lease liability payments are also included in this category.

Example 2

Irita's share capital for the years 2008 and 2009 was:

	2009	*2008*
	$	*$*
$1 equity share capital	58,000	35,000
Share premium	29,700	17,600
	87,700	52,600

During 2009 Irita made a 1 for 7 bonus issue capitalising the general reserve. In December 2009 she issued further shares at full market price.

Calculate cash proceeds from the issue of shares.

- **interest paid**

Example 3

Agnes' Statement of Financial Position extract as at 31 December, 2009

	2009	*2008*
Payables		
Accrued loan interest	18,000	74,000

Interest payable is shown in the Statement of Comprehensive Income as being $217,000. There are no bank loans or overdrafts.
Additionally Agnes entered into a finance lease during 2009.
Total payments to the finance lease creditor in the year were $9,000, of which $1,800 is interest.
Agnes has included the full $9,000 in the obligations under finance lease account.

Prepare relevant extracts from Agnes' Statement of Cash Flows

- **taxation paid**

taxation paid may need to be calculated from other data given to you. This is best achieved, as before, by putting the relevant figures into a T account or Schedule.

Example 4

In the Statements of Financial Position of Talis as at 31 December, 2008 and 31 December, 2009 were the following liabilities for taxation.

	2009	*2008*
	$'000	*$'000*
Income tax due	390	420

The Statement of Comprehensive Income taxation charge for 2009 was $400,000.

What is the amount of taxation paid during the year?

- **dividends paid**

  dividends paid by the entity can be classified in one of two ways:
  - as a financing cash flow, showing the cost of obtaining financial resources, or
  - as a component of cash flows from operating activities so that users can assess the entity's ability to pay dividends out of operating cash flows.

Example 5

Dovile's Statement of Financial Position extract as at 31 December, 2008 and 2009.

	2008	*2009*
Payables	*$'000*	*$'000*
Dividends payable	831	915

During 2009 Dovile paid an interim dividend of $600,000.

Calculate dividends paid by Dovile during the year ended 31 December, 2009.

Example 6 - Comprehensive example

Below are the Statements of Financial Position for Zita as at 31 December, 2009 and 31 December, 2008 and the Statement of Comprehensive Income for the year ended 31 December, 2009.

	2009		*2008*	
	$'000	*$'000*	*$'000*	*$'000*
ASSETS				
Non-current assets				
Intangible assets	1,415		817	
Tangible assets	832		681	
		2,247		1,498
Current assets				
Inventory	619		701	
Receivables	524		492	
Investments	396		125	
Cash	17		81	
		1,556		1,399
TOTAL ASSETS		3,803		2,897
EQUITY AND LIABILITIES				
Equity				
$1 equity shares	500		300	
Share premium	312		284	
Revaluation surplus	150		40	
Retained earnings	1,612		1,210	
		2,574		1,834
Non-current liabilities				
Provision for court case	73		50	
5% Debentures	220		88	
		293		138
Current liabilities				
Interest payable	100		30	
Dividends payable	81		140	
Tax payable	238		226	
Trade payables	517		529	
		936		925
TOTAL EQUITY AND LIABILITIES		3,803		2,897

Statement of Comprehensive Income

	$'000
Revenue	1,761
Cost of sales and expenses	(928)
Operating profit	833
Interest charge	(110)
Profit before tax	723
Income tax expense	(240)
	483
Dividends	(81)
Profit for the year	402
Retained earnings brought forward	1,210
Retained earnings carried forward	1,612

Notes:

(1) Intangible non-current assets represent deferred development expenditure. Amortisation in 2009 amounted to $43,000.

(2) Tangible non-current asset additions totalling $200,000 were made. Proceeds from the sale of tangible non-current assets were $103,000, on which Zita suffered a loss of $6,000.

(3) Investments include treasury bills of $32,000 acquired during 2009. Zita sees these as cash equivalents.

(4) During the year Zita had a 1 for 4 bonus issue of shares, financed by capitalising part of the share premium account. In December 2009 there was a further issue at full market price.

Prepare a Statement of Cash Flows for Zita for the year ended 31 December, 2009 in accordance with IAS 7 (revised).

Alternative Methods - Operating Activities

- IAS 7 (revised) allows two possible layouts for the Statement of Cash Flows in respect of operating activities:
  - the indirect method, the one used so far, and
  - the direct method.

- **Direct method**

the operating activities element of the Statement of Cash Flows is shown as follows:

	$'000
Cash flows from operating activities	
Cash receipts from customers	X
Cash paid to suppliers and employees	(X)
Cash generated from operations	X
Interest paid	(X)
Dividend paid	(X)
Taxation paid	(X)
Net cash from operating activities	X

- **cash receipts from customers**

this represents actual cash flows received during the accounting period in respect of sales.

- **cash paid to suppliers and employees**

this represents cash flows made during the accounting period in respect of goods and services and amounts paid to employees including the associated tax. It therefore includes gross salaries together with any other benefits (eg pension contributions).

Example 7

Jovita's Statement of Comprehensive Income for the year ended 31 December, 2009 and her Statement of Financial Position extracts as at that date were:

Statement of Comprehensive Income

	$'000	*$'000*
Revenue		2,933
Cost of sales		1,748
Gross profit		1,185
Administrative expenses	317	
Distribution costs	438	
		755
Profit before tax		430

Statement of Financial Position extracts

	2009 $'000	*2008 $'000*
Current assets		
Inventory	647	518
Receivables	491	625
Current liabilities		
Payables	329	401

You are told that:

(1) Administrative expenses include:

depreciation	84,000
employment costs	123,000
bad debt written off	17,000

(2) During 2009, Jovita sold an item of plant for $93,000 realising a profit on disposal of $15,000. This profit has been netted off administrative expenses

Prepare Jovita's Statement of Cash Flows for the year ended 31 December, 2009 for the section "Cash generated from operating activities" using:

(a) the indirect method, and

(b) the direct method

Chapter 20

INTERPRETATION OF ACCOUNTS – RATIO ANALYSIS

Introduction

- ratio analysis is a method traditionally used by people who wish to understand more fully the financial statements and performance of an entity.

- it may be used to identify unusual items, trends or financial problems but, to be of any use, it depends entirely on comparisons being made.

- **these comparisons may be between the subject entity and :**
  - the industry as a whole
  - subject entity's prior period results
  - management accounts
  - forecasts
  - other entities
  - other related figures elsewhere in the financial statements

- in isolation, a calculated ratio or multiple is **totally meaningless**, and no useful interpretation can be drawn.

Users of financial statements

- there is a variety of potential users of an entity's financial statements, each of whom may have different objectives

Example 1

How may the following users of financial statements benefit from ratio analysis?

(a) Shareholders

(b) Potential investors

(c) Bank and other capital providers

(d) Employees

(e) Management

(f) Suppliers

(g) Government

- **categories of ratios**
  - profitability
  - liquidity
  - gearing
  - investors' ratios.
- ratio analysis cannot answer questions. It can only raise matters for further consideration and investigation.
- it must be stressed that ratio analysis on its own is not sufficient for interpreting an entity's performance, and that there are other items of information which should be looked at, for example:
  - the content of any accompanying commentary on the financial statements and other statements;
  - the age and nature of the entity's assets;
  - current and future developments in the entity's markets, at home and overseas, and recent acquisitions or disposals of a subsidiary by the entity;
  - any other noticeable features of the financial statements, for example, events after the reporting period, contingent liabilities, a qualified auditors' report, the entity's taxation position, and involvement in research and development

The key ratios

- **Profitability**

Return on capital employed (or ROCE)	$\frac{\text{PBIT}}{\text{TALCL}}$	expressed as a percentage
PBIT	Profit before interest and tax. It is often referred to internationally as IBIT (Income before interest and tax)	
TALCL	Total assets less current liabilities. It is equal to the capital invested in the business (equity plus non-current liabilities)	
Profit margin	$\frac{\text{PBIT}}{\text{Revenue}}$	expressed as a percentage
Asset turnover	$\frac{\text{Revenue}}{\text{TALCL}}$	expressed as a multiple
Return on equity	$\frac{\text{Profit available for equity}}{\text{Equity shareholders' funds}}$	expressed as a percentage

- **Liquidity**

Current ratio	Current assets : Current liabilities	expressed as ratio eg 3:1
Quick ratio (or acid test)	Current assets less inventory : Current liabilities	expressed as a ratio
Inventory turnover	$\frac{\text{Cost of sales}}{\text{Average inventory}}$	expressed as a multiple
Receivables collection period	$\frac{\text{Trade receivables}}{\text{Credit sales}} \times 365$	expressed as a number of days
Payables payment period	$\frac{\text{Trade payables}}{\text{Credit purchases}} \times 365$	expressed as a number of days

- **Gearing**

Debt/equity	$\frac{\text{Interest bearing net debt}}{\text{Shareholders' funds}}$	expressed as a percentage
Debt/debt + equity	$\frac{\text{Interest bearing net debt}}{\text{Shareholders' funds + Interest bearing net debt}}$	expressed as a percentage
Net debt	long term debt net of any spare cash. In some cases, a long term bank overdraft is classed as long term debt.	
Interest cover	$\frac{\text{PBIT}}{\text{Interest payable}}$	expressed as a multiple

- **Investors' Ratios**

Dividend yield	Dividend per share / Mid market price (MMP)	expressed as a percentage
Dividend cover	Earnings per share (EPS) / Dividend per share	expressed as a multiple
Price earnings ratio (PE Ratio)	MMP / EPS	expressed as a multiple
Earnings yield	EPS / MMP	expressed as a percentage

Example 2

Elchin is thinking about buying a substantial interest in a competitor, Aurelija, and has a copy of Aurelija's financial statements for the year ended 31 December, 2009.

Elchin has asked you to analyse these statements and to write a report to him identifying areas which are worthy of note, and areas which will require further investigations.

Aurelija's financial statements are set out below:
Statement of Comprehensive Income for the year ended 31 December, 2009

	2009		*2008*	
	$'000	*$'000*	*$'000*	*$'000*
Revenue		1,220		1,000
Cost of sales		900		760
Gross profit		320		240
Administrative expenses	100		74	
Distribution costs	105	205	90	164
Operating profit		115		76
Interest charge		24		-
Profit before tax		91		76
Taxation		27		22
Profit after tax		64		54
Proposed dividends		24		20
Retained profit		40		34

Statement of Financial Position as at 31 December, 2009

	2009		*2008*	
	$'000	*$'000*	*$'000*	*$'000*
Tangible non-current assets				
Property, plant and equipment		3,600		3,900
Motor vehicles		13,000		12,000
		16,600		15,900
Current assets				
Inventory	225		120	
Receivables	280		125	
Cash	15		65	
		520		310
TOTAL ASSETS		17,120		16,210
Equity share capital $1 each		4,000		4,000
Retained earnings		12,048		12,008
		16,048		16,008
Non-current liabilities				

8% Convertible bonds		200		-
Current liabilities				
Payables	440		160	
Taxation	49		22	
Bank	359		-	
Proposed dividend	24		20	
		872		202
TOTAL EQUITY AND LIABILITIES		17,120		16,210

Chapter 21

IAS 33 EARNINGS PER SHARE

Need for EPS

- earnings per share (EPS) is a component part of the calculation of the Price Earnings Ratio (PE Ratio) which itself is often taken to be the most important ratio used by investment analysts. This is because it allows a direct comparative measure of entities operating in different industries and different markets.
- in addition, EPS allows analysts to compare an entity's performance over a period of time.
- because of these reasons, it was seen as necessary that a standard approach to the calculation of EPS should be defined.

IAS 33 Calculation

- **scope and disclosure**
  - applies to all entities with shares which are publicly traded.
  - show basic and diluted EPS on the face of the Statement of Comprehensive Income with equal prominence whether the result is positive or negative for each class of equity shares.
  - note showing:
    - earnings figure used (numerator) for both basic and diluted EPS and a reconciliation to the net profit or loss for the period;
    - weighted average number of equity shares used (denominator) in both the basic and diluted EPS calculation and a reconciliation between the two.

- **Earnings per share**
  - basic EPS is calculated as:

$$\frac{\text{Net profit or loss for the period attributable to equity shareholders}}{\text{Weighted average number of equity shares outstanding during the period}} \quad \text{expressed in cents}$$

  - net profit or loss attributable to equity shareholders is consolidated profit after
    - income tax
    - non-controlling interest
    - preference dividends

Changes in equity share capital

- **decreases in share capital** occur, rarely, when an entity buys back shares from its investors and cancels them.

- **increases in share capital (**can happen in a variety of ways):
  - issues at full market price
  - rights issues
  - bonus issues
  - capitalisation issues
  - scrip issues

  Note Capitalisation and scrip issues may be taken to be the same as bonus issues

- **issues at full market price**
  - theory suggests that the market price of a share represents the present value of the future earnings of that share, discounted for time. There is, therefore, no affect on the earning capacity of existing shares.
  - the weighted average number of equity shares calculation will be affected, but only to account for the increase with effect from the date of the issue.

- **rights issues**
  - a rights issue occurs when an entity offers to its existing shareholders the right to acquire more shares in the entity at a price lower than the current mid-market price ie at a discount on mid-market price
  - the rule to apply is:
    - multiply all prior periods this year by the RIGHTS FRACTION, and
    - multiply last year's disclosed EPS by the reciprocal of the rights fraction.

- **the rights fraction**

  The rights fraction is calculated as $\frac{\text{CRAP}}{\text{TERP}}$
  - what is CRAP? The cum-rights actual price ie the market price of the share immediately before the rights issue. That's CRAP
  - what is TERP? The theoretical ex rights price ie a calculated theoretical value per share immediately after the rights issue.
  - the calculation is best set out in a short working as illustrated.

Example 1

Svetlana had in issue at 1 January, 2009 5,000,000 $1 equity shares.
On 1 August, 2009 Svetlana made a 1 for 4 rights issue at an exercise price of $3. The mid-market price immediately before the rights issue was $4.
Earnings for the year available to equity shareholders was $3,000,000, and 2008 disclosed EPS was 54c

Calculate Svetlana's basic EPS for 2009, and restate the comparative figure.

- **bonus issues**
  - a bonus issue is a free issue of shares, given to existing shareholders. No extra funds are available to the entity.
  - a bonus issue is treated as though the additional shares had been in existence from the first day of the year, and an adjustment is required also, to reflect the issue, to the disclosed EPS for the previous year.

- **the rule to apply is:**
  - multiply all prior periods this year by the BONUS FRACTION, and
  - multiply last year's disclosed EPS by the reciprocal of the bonus fraction.

- **the bonus fraction**
  - The bonus fraction is calculated as:

$$\frac{\text{number of shares in issue after the bonus}}{\text{number of shares in issue before the bonus}}$$

  - if an entity had 400,000 shares in issue, and made a 1 for 8 bonus issue, then after the issue, there would be 450,000 shares in issue.

    so we could express the bonus fraction as $\frac{450{,}000}{400{,}000}$

  - but it is so much easier to express it on the basis of 8 shares originally moving to 9 shares after the bonus ie $\frac{9}{8}$

Example 2

Larissa had earnings of $600,000 and 2,000,000 $1 equity share capital at 1 March, 2008. On 31 August, Larissa issued 3,000,000 new shares at full market price, and on 1 November 2008, Larissa made a bonus issue of 2 new shares for every 7 already held. Last year's EPS was disclosed as 16c.

Calculate the basic EPS for Larissa for the year ended 28 February, 2009, and restate the comparative EPS.

Note, it is well worth counting the months on your fingers.

For example April – August could be	3 months	(30.4 – 1.8), or
	4 months	(30.4 – 31.8), or
	5 months	(1.4 – 31.8)

Diluted EPS Overview

- an entity will calculate, and disclose, its basic EPS prominently in the financial statements for each year.
- but the entity may have in issue financial instruments which allow the holder to convert those instruments into equity shares at some time in the future.
- on conversion, clearly the number of shares in issue will increase and, at the same time, the earnings available for equity may also change because, for example, the entity will no longer have to pay loan interest.

  Note: for the purpose of the exam, only two such instruments need to be considered:
  - options
  - convertible loans or bonds
- the principle behind the diluted EPS calculation is to show existing and potential investors the effect which these future conversions would have if the conversion date had been on the earliest day possible in the current year.
- put another way, if these future conversion rights had been able to be exercised at the start of the current year, but earnings had remained the same, what would the EPS figure be?

Diluted EPS Options

- options are often granted to directors and senior employees as an incentive for them to work harder for the entity. As a result of their efforts, the value of the entity will hopefully increase, and the share price will reflect this increase in value.

- on the date the options are granted, the exercise price will be higher than the current mid-market price, and the exercise date may be a number of years into the future.

- as time goes on, as a result of the directors' efforts, the mid-market price will increase to a level greater than the exercise price. But with options (sometimes called "warrants") the exercise price is fixed.

Note: only when the mid-market price exceeds the exercise price do we need to consider the options in the diluted eps calculation. In the exam this is the situation which you will face.

Example 3

Solveiga had in issue 4,000,000 $1 equity shares throughout the year ended 31 December, 2009, with an average mid-market price of $5. There were also 3,000,000 outstanding options, which had been granted to the directors, allowing them to exercise their option at $4 per share.
Earnings for the year ended 31 December, 2009 available for equity were $2,800,000.

Calculate the basic and diluted eps for Solveiga for the year ended 31 December, 2009.

Convertible loans or bonds

- when the loans are converted into equity shares, the entity will no longer have the loan interest as an expense. So pre-tax earnings will increase by the amount of the loan interest.

- but that means that taxable profits will also increase. So the saving for the entity will be only the net-of-tax loan interest.

Example 4

Kaspars, throughout the year ended 31 December, 2009 had in issue 2,000,000 equity shares and $3,000,000 6.25% convertible bonds. Each $1,000 bond is convertible into 760 equity shares on 31 December 2013, or 740 equity shares on 31 December 2014.
Earnings available for equity for the year ended 31 December, 2009 were $700,000 and the corporate income tax rate is 25%.

Calculate Kaspars' basic and diluted eps for the year ended 31 December, 2009.

- **maximum dilution**

  - so far we have considered, in each example, only one diluting instrument. But what if there is more than one? Clearly, all financial instruments outstanding could have a diluting affect, but one, or more, of them may in fact improve the basic EPS.

  - these are known as anti-dilutive, and are ignored for disclosure purposes ie we show the worst position possible in order to allow existing and potential investors to appreciate the maximum dilution.

  - where we are faced with more than one convertible financial instrument, the sequence in which we consider their impact is important.

- **the rule is:**

  - consider them in the sequence of "most diluting first"

  - to arrive at this sequence, it is necessary to calculate the "marginal earnings per share" for each conversion. When calculated, we must rank them in the correct sequence, and then apply them in that sequence in a working to establish the diluted eps.

Example 5

Edgars had in issue throughout the year ended 31 December, 2009 3,370,000 $1 equity shares, and earnings for the year, after tax at 25%, were $10,000,000. Of this amount, $900,000 was from discontinued operations. An average mid-market price for the year for Edgars' shares was $4.

In addition, Edgars had the following outstanding financial instruments:

- 520,000 options, exercise price $3.00, exercise date 31 December 2011
- 2,000,000 options exercise price $5.00 exercise date 31 December 2013
- $20,000,000 10.673% convertible bonds. Conversion terms are for each $1,000 bond the holder can acquire 18 equity shares on 31 December 2012 or 30 equity shares on 31 December 2014.

Calculate Edgar's basic and diluted eps for the year ended 31 December, 2009.

Convertible preference shares are a further possible diluting financial instrument.

Chapter 22

THEORETICAL MATTERS

- profit is the difference between an entity's capital at the beginning and the end of an accounting period
- but capital could be "financial" or "operating"
- financial capital is the aggregation of shares and reserves and is known as share-holders' funds
- objective of financial capital maintenance is to maintain shareholders' wealth
- capital (or physical capital) is the aggregation of non-current assets, inventories and monetary working capital
- objective of operating capital maintenance is to maintain operating capacity of the entity
- in achieving this, specific price changes are taken into account
- different accounting principles apply to different concepts
  - financial capital maintenance uses either nominal dollars or current purchasing power as the unit of measurement
  - operating capital maintenance uses nominal dollars
- how these possibilities combine can be summarised in the following table:

concept	*unit of measurement*	*assets valuation*	*system of accounting*
financial	cpp	historic cost	cpp
financial	nominal	historic cost	hca
operating	nominal	current cost	cca

Current purchasing power (cpp)

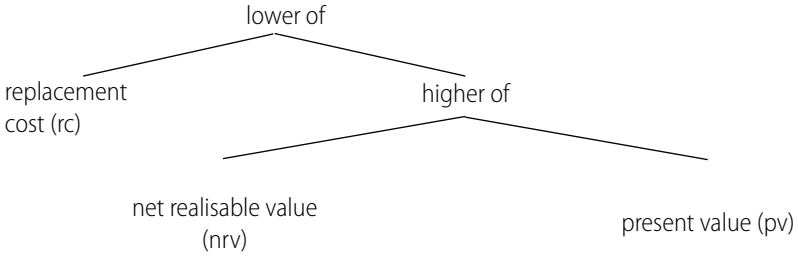
- some (or all!) of the items in the financial statements are restated for changes in general price levels compared with a stable monetary unit – the cpp
- changes in purchasing power are based on general level of inflation using the RPI
- cpp measures profits as the increase in the current purchasing power of equity. Profits are therefore stated after allowing for the fall in purchasing power resulting from inflation
- **effect on financial statement items**
  - monetary items and assets / liabilities fixed in $ terms by contract or statute?
  - adjustment is made to reflect fall in value if using cpp but no adjustment is made when using historic cost accounting
  - non-monetary items not fixed in $ terms by contract or statute? Adjustment is made to reflect change in value
- monetary items – value falls as inflation decreases purchasing power
- non-monetary items – value increases

Advantages and disadvantages of cpp

- **advantages:**
  - greater comparability resulting from asset value restatement
  - year by year comparisons have greater validity
  - subjectivity of other value measurement systems is avoided
  - being based on historic cost, as adjusted for indexation, the figures are auditable
  - gains and losses resulting from inflation are high-lighted
- **disadvantages**
  - use of indices necessarily involves approximation
  - what use are financial statements to a reader – majority rarely understand the figures even when based on the solid ground of historic costs
  - restatement of asset values represents neither value to business nor value realised – so no improvement on historic cost method

Current cost accounting (cca)

- cca is the system of accounting applied to the concept of operating capital maintenance
- the value of assets consumed or sold, and those in the statement of financial position are stated at their value to the entity
- value to the entity is known as deprival value
- deprival value is



- depreciation is charged on the asset based on gross replacement cost where replacement cost is the deprival value
- where nrv or pv is the deprival value, the charge against cca profits will be the loss of value of the asset
- goods sold are charged at their replacement cost. For example, an item of inventory which costs $25 is sold for $32 by which time its replacement cost has risen to $28
- **cca trading account would show:**

revenue	32
replacement cost of goods sold	(28)
current cost profit	4

Advantages and disadvantages of cca and disclosures

- **advantages:**
  - better assessment of stability, vulnerability, liquidity and future prospects
  - as a result of eliminating holding gains, there's a better indication of whether dividends will reduce operating capacity

- **disadvantages:**
  - finding suitable indices could be a problem
  - determining nrv and pv could be a problem

- before IAS 15 was withdrawn, the following disclosures were recommended:
  - the amount of adjustments to depreciation, cost of sales, monetary items, borrowing and equity interests
  - affect of adjustments on other items
  - if cca is used, the current cost of property, plant and equipment as well as inventories
  - a description of the method used in computing the adjustments

Chapter 23

IAS 16 PROPERTY, PLANT AND EQUIPMENT

- **principal issues:**
  - timing and recognition
  - determination of carrying amount
  - depreciation charge to be recognised
- IAS 16 does not apply to forests and similar regenerative natural resources, nor to minerals, oils and similar non-regenerative natural resources
- **residual value** is the net amount which the entity expects to obtain for an asset at the end of its useful life after deducting the expected costs of disposal.
- **fair value** is the amount for which an asset could be exchanged between knowledgeable, willing parties in an arm's length transaction.
- **carrying amount** is the amount at which an asset is recognised in the Statement of Financial Position after deducting any accumulated depreciation and accumulated impairment losses.
- an **impairment loss** is the amount by which the carrying amount of an asset exceeds its recoverable amount.
- **recognise an asset when:**
  - it is probable that future economic benefit will flow to the entity, and …
  - … cost of the asset can be reliably measured

Benchmark Treatment

- should be carried at cost less accumulated depreciation
- cost includes purchase price, import duties and non-refundable purchase taxes …
- …but is net of trade discounts and rebates
- cost also includes expenses directly attributable to bringing the asset to a working condition

- **examples:**
  - site preparation costs
  - delivery and handling costs
  - installation costs
  - professional costs eg engineers and architects
  - estimated costs of disassembly and site restoration
- subsequent expenditure should only be recognised as an asset when, as a result, there is improvement in the asset's standard of performance
- **examples:**
  - modifications which extend the asset's useful life
  - upgrading an asset to improve its performance

PPE – allowed alternative (revaluation model)

- subsequent to initial recognition at cost, ppe can be carried at a revalued amount but only if fair value can be reliably measured
- revalued amount is fair value at date of revaluation less subsequent accumulated depreciation and impairment losses
- revaluations should be carried out regularly
- accumulated depreciation at the revaluation date should either be restated proportionately, for example if indexing is used, or …
- … eliminated in accounting for the revaluation
- **double entry on revaluation**

  Dr accumulated depreciation (until reduced to $ nil)
  Dr ppe
  Cr revaluation reserve
- revaluation reserve transferred to retained earnings when asset sold, or …
- … proportionately transferred to retained earnings throughout the asset's remaining life
- **fair values:**
  - land and buildings – market value determined by professionally qualified valuers
  - ppe- market value determined by appraisal
  - if no recognised market, value at depreciated replacement cost

Chapter 24

IAS 18 REVENUE

- revenue relates to both income and gains arising in the ordinary course of business
- it includes sales, services, interest, royalties and dividends
- it excludes trade discounts and VAT
- should be measured at fair value of consideration received
- if consideration is deferred, amount should be discounted
- if sales financed by the seller, difference between apparent sale value and fair value should be recognised as finance income
- **sale of goods recognised when all criteria are met:**
  - transfer of significant risks and rewards
  - no continuing managerial involvement nor effective control of goods sold
  - revenue can be reliably measured
  - probable inflow of related economic benefits
  - reliable measurement of transaction costs

Revenue recognition and disclosure

- recognition of revenue from provision of services when all criteria met:
  - same criteria as last four from previous page, and …
  - … stage of completion can be reliably measured
  - interest recognised on a time apportioned basis
  - royalties recognised on an accruals basis
  - dividends recognised when rights to dividend are established
- **disclosure**
  - accounting policy for recognition
  - amount of each significant element of revenue
  - amount of revenue arising from exchange of goods or services

Chapter 25

IAS 20 GOVERNMENT GRANTS

- recognise only when reasonable assurance that any conditions have been met and that grant will be received
- if based on expenses, accruals concept applies
- shown either as "other income" or netted off the related expense
- if asset related, show either as deferred income or net off against the cost of the asset
- if grant is to be repaid, set against the deferred income
- if greater than balance on deferred income account, expense the excess immediately

- **disclosure**
  - accounting policy
  - nature and extent of grants recognised
  - any unfulfilled conditions or contingencies relating to grants recognised

Chapter 26

IAS 38 INTANGIBLE ASSETS

- an identifiable non-monetary asset without physical substance held for use in the production or supply of goods or services, for rental to others, or for administrative purposes

- **recognise if (and only if):**
  - probable future economic benefit attributable to the asset will flow to the entity, and …
  - … cost can be reliably measured
- benchmark treatment is cost less accumulated amortisation and impairment losses
- allowed alternative is revalued amount less accumulated amortisation and impairment losses
- if following alternative, revaluation should be fair value by reference to an active market
- all assets in a class should be revalued unless there is no active market, in which case follow benchmark
- revaluation exercise should take place regularly so that carrying value is not wildly different from fair value
- internally generated intangible assets should not normally be recognised as intangible assets
- expenditure previously expensed should not be reversed and capitalised

Development expenditure

- research costs? expense
- development costs? capitalise if it satisfies the criteria:
  - defined project
  - environmentally satisfactory
  - feasible technically
  - expenses clearly allocable
  - reliable measurement
  - resources exist to carry the project through
  - extent of deferral restricted to assured recovery
  - do not write back any costs previously expensed

IAS 38 Amortisation and disclosure

- amortise on a systematic basis over anticipated useful life
- usually not more than twenty years
- commence amortisation when asset is available for use
- amortisation period and method should be reviewed at least annually
- recoverable amount reviewed annually and impaired as necessary
- **disclosure**
  - distinguish between internally generated and other intangible assets
  - useful lives of assets and amortisation methods
  - gross carrying amount and accumulated amortisation at start and end of period
  - which item in statement of comprehensive income includes the amortisation expense
  - if research and development, how much charged this year as an expense

Chapter 27

IAS 40 INVESTMENT PROPERTIES

- property (land, building or part of building) held either as owner or finance lessee to earn rentals or for capital appreciation or both rather than for:
  - use in production of goods, supply of service or administrative purposes, or …
  - …sale in the ordinary course of business
- recognition when, and only when …
  - probable inflow of future economic benefit
  - cost can be reliably measured
- initial recognition should be at cost
- cost includes purchase price and directly attributable expenses such as legal and architectural fees
- for self-constructed investment properties, cost is cost at the date when construction or development is complete
- subsequent expenditure capitalised only if it improves the likely future economic inflow of resource
- otherwise, it's expensed as a period cost

Measurement and transfers

- subsequent to initial recognition, entity may choose cost model (benchmark) or fair value model (allowed alternative)
- cost model? carry at fair value based on market state and circumstances
- resulting gains and losses included within statement of comprehensive income for the year
- assets should be transferred into or out of investment property when there is a change in use, for example:
  - owner occupation (investment property ⇒ TNCA)
  - development with a view to sell (investment property ⇒ inventory)
  - end of owner occupation (TNCA ⇒ investment property)
  - start of operating lease (inventory ⇒ investment property)
  - end of construction or development (assets in the course of construction ⇒ investment property)

IAS 40 disclosure

- movement during the year
- criteria used to distinguish owner-occupied from investment (where classification is not clear)
- methods and assumptions used in determining fair value
- extent to which fair value has been determined by an outside expert
- statement of comprehensive income elements of:
  - rental income
  - operating expenses incurred on investment properties
- whether there are any restrictions on realisability or remittance of disposal proceeds or income
- any material contractual obligations to purchase, construct or maintain investment properties
- depreciation methods and useful lives – when using the cost model
- if fair value model used generally, but it's not possible to establish fair value of particular investment properties, then:
  - description
  - explanation of why fair value cannot be reliably measured
  - if possible, disclose a range of estimates
  - the fact of a disposal, carrying amount and gain or loss arising on a property not carried at fair value

Chapter 28

IFRS 9 FINANCIAL INSTRUMENTS

- to be applied from 1 January, 2013
- but early adoption encouraged
- still to be dealt with:
  - new requirements for impairment of financial assets measured at amortised cost, and
  - hedge accounting
- initial measurement
  - all financial instruments to be measured at fair value inclusive of transaction costs
  - this new rule also applies to financial liabilities not measured at fair value through profit and loss (fvtpl)
- subsequent measurement
  - financial assets are now to be sub-divided into just two categories
    - those measured at amortised cost, and
    - those measured at fair value
- classification is determined on the date of initial recognition
- debt instruments
  - can be measured at amortised cost if they satisfy two conditions:
    - business model test – the asset is held with the intention of realising its cash flows rather than being held for early sale, and
    - cash flow characteristics test – the asset terms are such that cash flows will arise on specific dates in the future representing interest payments and principal repayments

    if they do not satisfy these two tests, they must be measured at fvtpl
  - fair value option
    - even if they do, in fact, satisfy these two tests they may still be valued at fvtpl if, by doing so, it eliminates or significantly reduces a measurement or recognition inconsistency
- equity instruments
  - measured at fair value in the SoFP
  - any change in value goes through SoI (or SoCI if chosen)
  - that choice is not reversible!
  - so only dividend income will be shown in SoI
- fair value of an asset
  - it may well be that "cost" is the best indicator of fair value – but the IFRS allows other means

- subsequent measurement of financial liabilities
  - still the same two possibilities as before:
    - fvtpl, and
    - amortised cost
  - financial liability held for trading? – fvtpl
  - otherwise at amortised cost unless the fair value option is exercised

- financial liabilities may be measured at fvtpl if:
  - it eliminates or significantly reduces a measurement or recognition inconsistency, or
  - it is part of a group of financial liabilities that is managed and performance is evaluated on a fair value basis in accordance with a documented risk management or investment strategy and information is provided to management on that basis
  - a financial liability which does not meet either of these criteria may still be measured at fvtpl when it contains one or more embedded derivatives that would otherwise require separation

- a ***financial instrument*** is defined as any contract that gives rise to both a financial asset of one entity and a financial liability or equity instrument of another entity.

- a ***financial asset*** is any asset that is
  - cash;
  - a contractual right to receive cash or another financial asset from another entity:
  - a contractual right to exchange financial instruments with another entity under conditions that are potentially favourable; or
  - an equity instrument of another entity

- a ***financial liability*** is any liability that is a contractual obligation:
  - to deliver cash or another financial asset to another entity, or
  - to exchange financial instruments with another entity under conditions that are potentially unfavourable.

- an ***equity instrument*** is any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities.

Presentation and classification

- should be classified by the issuer as either equity or debt

- substance rather than form should determine the classification

- key feature is whether there exists a contractual obligation involving outflow of economic resource

- interest, dividends, gains or losses relating to a financial liability should be reported in statement of comprehensive income as either income or expense

- distributions to holders of financial instruments classified as equity should be charged directly to equity

Example 1

On 1 January, 2009 James issued a deep discount bond of $360,000 for proceeds of $314,354. Interest of 6% is payable annually on 31 December. The bond will be redeemed on 31 December, 2012.

Therefore the total cost of borrowing to be charged through the Statement of Comprehensive Income over the four year period is made up as follows:

	$
Annual interest payments (4 × 6% × 360,000)	86,400
Deep discount (360,000 – 314,354)	45,646
	132,046

The internal rate of return is 10%

Show the Statement of Comprehensive Income charge and carrying value of the bond for each of the years of the bond's life, 2009 - 2012.

Equity instruments and warrants

- **examples of equity instruments include**
  - equity shares
  - some preference shares
  - warrants and options to subscribe for equity shares
- an obligation to issue equity shares in exchange for financial assets of another entity is not potentially unfavourable since it results in increased equity and cannot result in a loss to the entity
- warrants involve the right to buy shares at a fixed price during a fixed period
- warrants should be recorded at the net proceeds of the issue and should be included in equity
- when a warrant is exercised the amount previously recognised in respect of the warrant will be included as part of the net proceeds of the shares issued
- if a warrant lapses, the amount previously recognised will be transferred to reserves and reported within the statement of changes in equity

Example 2

On 1 January, 2009 Zana issued 300,000 warrants at $0.10 each.
The warrant holders have the right to purchase $1 equity shares for a further $1.40 during the year ended 31 December, 2012.

(a) How should Zana account for the warrants in the financial statements for the year ended 31 December, 2009?
During the year ended 31 December, 2012, the holders of 250,000 warrants exercised their option.

(b) How should Zana account for this in the financial statements for the year ended 31 December, 2012?

Compound instruments

- a financial instrument can exist which contains an element of equity and an element of debt
- the separate components should be measured and accounted for appropriately
- **IAS 32 suggests two ways of evaluating the separate components:**
  - calculate the value of the element which is easier to assess. This value is then deducted from the total instrument value and the resultant amount is therefore the value of the second component
  - calculate both elements separately. If the combined value exceeds the total instrument value then reduce both component values proportionately

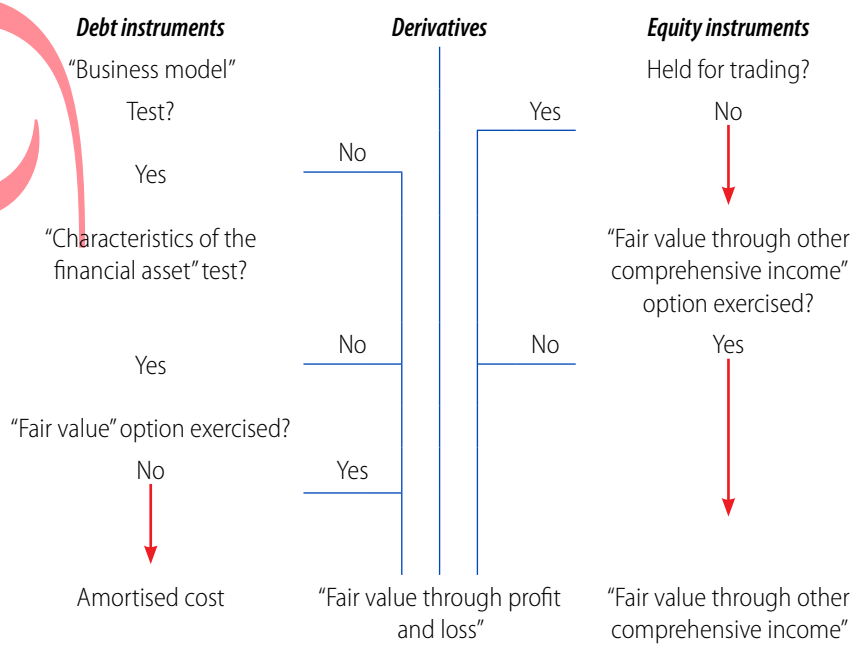
Example 3

Helena issued 80,000 8% convertible bonds of $100 each on 1 January, 2009.
The terms of issue allowed the holders to convert their investment into 10 $1 equity shares on 31 December 2013.
The market rate of interest for a non-convertible 5 year bond is 10%.

Calculate the debt and the equity elements of Helena's compound instrument.

Disclosure

- a narrative explanation of outstanding financial instruments is strongly recommended.
- disclosure requirements apply to all types of financial instruments
- disclosure requirements are categorised by type of risk
- four different risks may be faced by an entity:
  - price, credit, liquidity and cash flow
- price risk further subdivides into:
  - currency risk – the risk of value fluctuation as a result of changes in foreign exchange rates
  - interest rate risk – the risk of value fluctuation as a result of changes in market interest rates
  - market risk – the risk of value fluctuation as a result of changes in market prices
- these changes in market price may be caused by matters specific to the entity or the instrument itself or even general matters affecting all instruments traded in the market
- remember, risk can be upside as well as downside
- credit risk – the risk that one party to the instrument will fail to discharge an obligation therefore causing the other party to suffer financial loss
- liquidity risk (or funding risk) – the risk of being unable to raise funds necessary to discharge a financial instrument obligation. Could also result from an inability to sell a financial instrument quickly for an amount similar to its fair value
- cash flow risk – the risk of variation in the future cash flows associated with a financial instrument. An example would be where an entity has in issue a floating rate debenture
- Classification and measurement of financial assets



Financial instruments, financial liabilities.

- classified either as:
  - fair value through profit and loss, or ...
  - … amortised cost

	fair value through profit and loss	*amortised cost*

includes	• held for trading
	• derivatives (unless hedges)
	• those classified as "fair value through profit and loss"
		• everything else
		• examples:
		  • accounts payable
		  • loans payable
		  • debt instruments
		  • deposit from customers

reclassification	• not allowed, neither into nor out of	• not allowed, neither into nor out of
initial valuation	• fair value	• fair value
changes in value	• SOCI	• SOCI
subsequent valuation	• fair value	• amortised cost or fair value
impairment	• not applicable	• not applicable

- gains and losses from financial liabilities at fvtpl should be split between:
  - any change attributable to credit risk (show in SoCI), and
  - any other change (show in SoI)
  - however, all change may go through SoI if to include within SoCI would create or enlarge an accounting mismatch in SoI
  - this decision is made on initial recognition and is not reversible
  - in addition, once the change has been entered through SoCI, it cannot later be transferred back through SoI
  - the only transfer available is through the Statement of Changes in Equity

- derecognition of financial assets
  - it is necessary to determine whether a financial asset is:
    - an asset in its entirety, or
    - specifically identified cash flows from an asset, or
    - fully proportionate share of the cash flows from an asset, or
    - fully proportionate share of specifically identified cash flows from an asset
- if it satisfies any of these four, then assess whether the asset has in fact been transferred and, if so, is the asset eligible for derecognition
- it is transferred if
  - contractual rights to cash flows have been transferred, or
  - the rights have not been transferred but the entity has assumed an obligation to pass on these flows, or
  - under an arrangement which meets three criteria:
    - the entity has no obligation to pay the "transferee" unless it collects equivalent amounts on the asset, and
    - the entity is prohibited from selling or pledging the asset, and
    - the entity has an obligation to remit these cash flows without material delay
- once it has been established that the asset has in fact been transferred, then it's necessary to determine whether "substantially the whole of the risks and rewards of ownership" have also been transferred
  - if they have, then the asset is derecognised
  - if not, then it is not derecognised
  - if neither "yes" nor "no" the entity must then assess whether it has relinquished control
    - if yes, then derecognise
    - if no, then continue to recognise to the extent of the entity's continuing involvement

- derecognition of financial liabilities
  - derecognise when the liability has been extinguished by
    - discharge, or
    - cancellation, or
    - expiry
- where a liability is exchanged for a different liability with substantially different terms
  - the replacement is recognised, and
  - the original liability is extinguished, and
  - any gain or loss on extinguishing the original is taken through SoI
- derivatives
  - are all measured at fair value, with
  - any change in value going through SoI, unless …
  - … the entity has elected to treat the derivative as a hedge in which case the change will be reflected through Statement of Changes in Equity
- embedded derivative
  - is a component of a hybrid contract which contains a non-derivative host
  - as a result, some of the cash flows vary, and some are fixed
- any derivative which is capable of being dealt with as a separate element – ie it can be transferred independently – is not embedded
- it's a separate financial instrument
- reclassification
  - financial assets are held at either fvtpl or at amortised cost
  - they can only be reclassified if the business model changes and no longer applies
  - if reclassification is appropriate, this should be done prospectively
    - so no re-statement of prior gains or losses
    - and no re-statement of interest
  - cannot reclassify where
    - a financial asset was treated under the SoCI option, nor
    - where the fair value option has been exercised

Example of amortised cost subsequent measurement

- this is the cost of an asset, or liability, adjusted to achieve a constant effective interest rate over the life of the instrument.
- for example, the amortised cost of an investment in a debt instrument at 1 January, 2010 was $ 60,000. There has been no payment of interest or capital in the year, and the effective interest rate is 5%. The amortised cost at the end of 2010 will be $63,000 (60,000 + 5% × 60,000)
- because equity shares do not have fixed or determinable payment dates, it is not possible to calculate amortised cost.
- they cannot therefore be classified in the above three categories.
- in calculating amortised cost, an entity must use the effective interest rate method.
- this method will also determine how much interest income, or expense, should be recognised in the Statement of Comprehensive Income.

Example 4

On 1 January, 2010, an entity purchased a loan note which carried interest at 5%, payable annually at the end of each year. The principal value of the note of $50,000 is repayable on 31 December, 2014. The cost of the investment was $44,011, and the entity has classified it as held-to-maturity. An effective rate of interest is 8%

	Amortised cost b/f	*Interest at 5%*	*Effective interest at 8%*	*Amortisation for the year*	*Amortised cost c/f*
2010	44,011	2,500	3,521	1,021	45,032
2011	45,032	2,500	3,603	1,103	46,134
2012	46,134	2,500	3,691	1,191	47,325
2013	47,325	2,500	3,786	1,286	48,611
2014	48,611	2,500	3,889	1,389	50,000

ANSWERS TO EXAMPLES

Chapter 1

Answer to Example 1

Accruals	Inventory should be included in cost of sales. The premises should be included in Property, Plant and Equipment and depreciated over their estimated useful life. Goodwill should be capitalised and reviewed annually for impairment.
Consistency	How has Laima treated similar purchases in the past?
Going Concern	Capitalising the premises and goodwill is only appropriate if Laima's business is likely to continue into the foreseeable future.
Materiality	Adjust Laima's incorrect treatment of property and goodwill only if their value is material in Laima's business financial statements.
Offsetting	The expenses and assets should not be offset against revenues and liabilities.

Chapter 2

Answer to Example 1

Advantages	*Disadvantages*
Comparability (for global investors)	Could be inconsistent with local legislation
Investigations (like due-diligence) will be easier	Different user groups may have different needs.
Take-overs of overseas entities will be easier	
State Revenue Service will more easily be able to understand the financial statements of overseas entities.	

Chapter 3

Answer to Example 1

Statement of Income

Profit for the year from continuing operations		421
Profit for the period		421
Other recognised income and expense		
Surplus on property revaluation	105	
Impairment loss	(25)	
		80
		501

Statement of Changes in Equity

	Share capital	*Share premium*	*Revaluation surplus*	*Retained earnings*	*Total*
	$'000	*$'000*	*$'000*	*$'000*	*$'000*
Brought forward	400	50	165	310	925
Profit for the period				421	421
Property revaluation			80		80
Dividend				(98)	(98)
Share issue	200	50			250
	600	100	245	633	1,578

Chapter 4

Answer to Example 1

Ruta Co Statement of Comprehensive Income for the year ended 31 December, 2009

	$000 2009	*$000 2008*
Revenue	640	480
Cost of sales	(260)	(215)
Gross Profit	380	265
Administrative expenses	(60)	(48)
Distribution costs	(87)	(56)
Profit from continuing operations	233	161
Discontinued operations	(3)	(1)
	230	160

Chapter 5

Answer to Example 1

Adomas Statement of Income for the year ended 31 December, 2009

	2009 $'000	*2008 $'000*
Revenue	2,600	2,500
Costs and expenses	(1,400)	(1,200)
Profit for the year	1,200	1,300

Adomas Statement of Financial Position as at 31 December, 2009

	2009 $'000	*2008 $'000*
		as restated
TNCA	2,300	1,500
Current assets	1,700	800
	4,000	2,300
Share capital	600	600
Retained earnings	2,700	1,500
Revaluation reserve	300	–
	3,600	2,100
Current liabilities	400	200
	4,000	2,300

Adomas Statement of Comprehensive Income

	2009 $000	*2008 $'000*
Surplus on revaluation of properties	300	–
Net gains not recognised in the Statement of Income	300	–
Net profit for period	1,200	800
Total recognised gains and losses	1,500	800
Affect of material error		(500)

Answers to Examples

Adomas Statement of Changes in Equity

	Share capital	*Revaluation reserve*	*Retained earnings*	*Total*
	$'000	*$'000*	*$'000*	*$'000*
Balance at 31 December, 2008	600	–	2,000	2,600
Material error	–	–	(500)	(500)
Restated balance	600	–	1,500	2,100
Surplus on revaluation of properties		300		300
Net gains not recognised in the Statement of Income		300		300
Net profit for the year			1,200	1,200
Balance at 31 December, 2009	600	300	2,700	3,600

Chapter 6

Answer to Example 1

The investment in Gediminas will be recorded as:

Dr	Investment in Gediminas	$3,000	
Cr	Cash		$3,000

Vytautas's Statement of Financial Position will now comprise:

	$	*$*
Assets		
Non-current assets		
Plant and equipment		50,000
Investment in Gediminas		3,000
		53,000
Current assets		
Inventory	8,000	
Receivables	6,000	
Cash	1,000	
		15,000
		68,000
Equity		
Share capital		40,000
Retained earnings		20,000
		60,000
Current liabilities		8,000
Total equity and liabilities		68,000

Answer to Example 2

Size of Investment	*Extent of influence achieved*	*Accounting treatment*
0% to < 20%	No significant influence	As an investment, accounting only for dividends received
20% to ≤ 50%	Significant	As an associate under the Equity Method
> 50%	Total control	Acquisition accounting

Chapter 7

Answer to Example 1

Rasa Group Consolidated Statement of Financial Position as at 1 January, 2009

		$
Other assets	(30 + 20)	50,000
Share capital	Only Rasa	20,000
Retained earnings	See note (p34)	22,000
		42,000
Liabilities	(6 + 2)	8,000
		50,000

Answer to Example 2

Rasa Group Consolidated Statement of Financial Position as at 31 December, 2009.

		$
Other assets	(40 + 26)	66,000
Share capital	Only Rasa	20,000
Retained earnings	((31 + 100% (14 - 10))	35,000
		55,000
Liabilities	(7 + 4)	11,000
		66,000

Answer to Example 3

Aurimas Group Consolidated Statement of Financial Position as at 31 December, 2009

		$
Other assets	(40 + 30)	70,000
Share capital	(Aurimas only)	10,000
Retained earnings	(W3)	49,000
		59,000
Liabilities		11,000
		70,000

Workings

W1

A
|
100%
|
0

W2 Goodwill

NOT YET APPLICABLE

W3 Consolidated retained earnings

	A	*O*
per question	42,000	15,000
– pre acquisition	–	(8,000)
∴ post acquisition	42,000	7,000
Aurimas' share	7,000	100%
	49,000	

Answer to Example 4

Maruta Group Consolidated Statement of Financial Position as at 1 December, 2009.

		$
Goodwill	(W2)	10,000
Other assets	(40 + 27)	67,000
		77,000
Share capital	Only Maruta	25,000
Retained earnings	(W3)	36,000
		61,000
Liabilities	(9 + 7)	16,000
		77,000

Workings

W1

M
|
100%
|
L

Answers to Examples

W2 Goodwill

Cost of investment		30,000
Net assets @ doa		
Shares	15,000	
Retained earnings	5,000	
		20,000
Goodwill		10,000

W3 Consolidated retained earnings

	M	*L*
per question	36,000	5,000
– pre acquisition	–	(5,000)
∴ post acquisition	36,000	–
M's share	–	100%
	36,000-	

Answer to Example 5

	$
Goodwill (W2)	3,000
Other assets (24 + 30)	54,000
	57,000
Share capital	18,000
Cons retained earnings (W3)	22,600
Non-controlling interest (W4)	10,400
	51,000
Liabilities (2 + 4)	6,000
	57,000

W1

A
|
| 60%
|
D —— 40%

W2 Goodwill

Cost of investment		16,000
Nci valuation		8,000
		24,000
Net assets @ doa		
Shares	20,000	
Retained earnings	–	
		20,000
Goodwill		4,000
Impaired since acquisition		(1,000)
CS of FP		3,000

W3 Consolidated retained earnings

	A	*D*
per question	20,000	6,000
– pre acq		–
		6,000
Ausra's share	3,600	60%
	23,600	
– Goodwill impaired since acq	(1,000)	
	22,600	

W4 NCI (40%)

Value @ doa	8,000
Share of S post acq ret'd 40% x 6,000	2,400
	10,400
Less: their share of impairment	–
none - originally valued on a proportionate basis	10,400

Answer to Example 6

Remigijus Group Consolidated Statement of Financial Position as at 31 March, 2010.

	$
Goodwill (W2)	11,000
Other assets (100 + 150)	250,000
	261,000
Shares	50,000
Retained earnings (W3)	118,500
NCI (W4)	32,500
	201,000
Liabilities (40 + 20)	60,000
	261,000

W1

R
| 75%
| ——— 25%
I

W2 Goodwill

Cost of investment		80,000
NCI investment valuation		23,000
		103,000
NA @ DOA		
Shares	32,000	
Ret earnings	60,000	
		92,000
Goodwill		11,000

W3 Consolidated retained earnings

	R	*I*
per q	90,000	98,000
- pre acq		60,000
∴ post acq		38,000
our share	28,500	75%
	118,500	

W4 NCI (25%)

Value @ doa	23,000
Share of S post acq ret'd 25% x 38,000	9,500
	32,500
Less their share of impairment – none, originally valued on a proportional basis	–
	32,500

Answers to Examples

Answer to Example 7

	$
Goodwill (W2)	35,000
Other net assets (60 + 190)	250,000
	285,000
Share capital	70,000
Retained earnings (W3)	132,000
NC Interest (W4)	83,000
	285,000

W1

I
| 60%
G —— 40%

W2 Goodwill

Cost of investment		100,000
Nci investment valuation		55,000
		155,000
Net assets @ doa		
Shares	80,000	
Retained earnings	40,000	
		120,000
Goodwill		35,000

W3 Consolidated retained earnings

	Ivona	*Guido*
per q	90,000	110,000
- pre acq		40,000
∴ post acq		70,000
our share	42,000	60%
	132,000	

W4 NCI (40%)

Value @ doa	55,000
Share of S post acq ret'd 40% × (110,000 - 40,000)	28,000
	83,000

Answer to Example 8

	$
Goodwill (W2)	32,800
Other assets (60 + 190)	250,000
	282,800
Shares	70,000
Retained earnings (W3)	132,000
Nci (W4)	80,800
	282,800

W1 No change

W2 Goodwill

Cost of investment		100,000
Nci investment valuation 40% x 80,000 x $1.65		52,800
		152,800
Net assets @ doa		
Shares	80,000	
Retained earnings	40,000	
		120,000
Goodwill		32,800

W3 No change

W4 NCI (40%)

Value @ doa	52,800
Share of S post acq ret'd 40% × 70,000	28,000
	80,800

Answer to Example 9

Ivona / Guido (1) impairing goodwill

		$
Goodwill	(W2)	31,500
Other net assets		250,000
		281,500
Shares		70,000
Retained earnings	(W3)	129,900
NC Interest	(W4)	81,600
		281,500

W1 No change

W2 Goodwill

Goodwill as calculated	35,000
Impair by 10%	3,500
	31,500

W3 Consolidated retained earnings

As calculated	132,000
Less goodwill impairment, Ivona's share only (60% × 3,500)	(2,100)
	129,900

W4 NCI (40%)

Value @ doa	55,000
Share of post acq retained (40% × 70,000)	28,000
	83,000
Less: share of impairment (40% × 3,500)	1,400
	81,600

Answers to Examples

Answer to Example 10

Robertas Group Consolidated Statement of Financial Position as at 31 December, 2009.

	$
TNCA (12 + 30)	42,000
Other assets (13 + 4)	17,000
	59,000
Share capital	5,000
Retained earnings (W3)	41,875
NC Interest (W4)	7,625
	54,500
Liabilities (1 + 3.5)	4,500
	59,000

W1

R
|
| 75%
I —— 25%

W2 Goodwill

Cost of investment		15,000
Nci investment valuation		7,000
		22,000
Net assets @ doa		
Shares	3,000	
Premium	1,500	
Ret ears b/f	20,000	
7 months profit	3,500	
		28,000
Goodwill		(6,000) to S of CI

W3 Consolidated retained earnings

	R	*I*
per question	34,000	26,000
– pre acquisition	–	(23,500)
∴ post acquisition	34,000	2,500
our share	1,875	75%
	35,875	
Goodwill	6,000	
	41,875	

W4 Nci (25%)

Value @ doa	7,000
Share of S post acq ret'd 25% x 2,500	625
	7,625

Answer to Example 11

Dalius Group Consolidated Statement of Financial Position as at 31 December, 2009.

			$
	INCA	(W2)	99,500
	Non-depreciable non-current		15,000
	Depreciable non-current		18,000
	Other assets	(350 + 300)	650,000
			782,500
	Shares	D Only	200,000
	Retained earnings	(W3)	393,600
	NC Interest	(W4)	78,900
			672,500
	Liabilities	(40 + 70)	110,000
			782,500

W1

D
|
70%
|
R —— 30%

W2 Goodwill

Cost of investment		250,000
Nci investment valuation		64,500
		314,500
Net assets @ doa		
Shares	130,000	
Retained earnings	20,000	
Fair value adjustments		
Inventory	20,000	
Non-depreciable non-current	15,000	
Depreciable non-current	30,000	
		215,000
		99,500

W3 Consolidated retained earnings

	Dalius	*Ramuna*
per question	360,000	100,000
Fair value adjustments as at today		
Inventory		–
Non-depreciable non-current		15,000
Depreciable non-current (2 years after acquisition) 30,000 × 60%		18,000
		133,000
Less pre -acq		85,000
		48,000
Dalius's share	33,600	70%
CSFP	393,600	

W4 Nci (30%)

Value @ doa	64,500
Share of S post acq ret'd 30% x 48,000	14,400
	78,900

Answers to Examples

Chapter 8

Answer to Example 1

Jurate Group Consolidated Statement of Financial Position as at 31 December, 2009.

			$
TNCA	(400 + 150)		550,000
CA			
Inventory	(70 + 50 + 10)	130,000	
Receivables	(80 + 70)	150,000	
Cash	(30 + 30 + 20)	80,000	
			360,000
			910,000
Shares	J Only		500,000
Retained earnings	(W3)		221,000
NC Interest	(W4)		69,000
			790,000
Liabilities	(110 + 10)		120,000
			910,000

W1 J

70%

D —— 30%

W2 Goodwill

Cost of investment		140,000
Net assets @ doa		60,000
		200,000
Shares	200,000	
Retained earnings	–	
		200,000
No Goodwill		–

W3 Consolidated retained earnings

	Jurate	*Dovile*
per question	200,000	30,000
less pre-acq		–
∴ post acq		30,000
Jurate's share	21,000	70%
	221,000	

W4 NC Interest (30%)

Value @ doa	60,000
Share of S post acq ret'd 30% x 30,000	9,000
	69,000

Answer to Example 2

Petras Group Consolidated Statement of Financial Position as at 31 December, 2009.

		$'000	$'000
TNCA	(500 + 250)		750
CA			
Inventory	(130 + 70 - 12)	188	
Other current assets	(100 + 60)	160	
			348
			1,098
Shares	P Only		450
Retained earnings	(W3)		403.5
NC Interest	(W4)		84.5
			938
Liabilities	(130 + 30)		160
			1,098

W1 P
75%
S — 25%

W2 Goodwill

Cost of investment		150,000
Nci investment valuation		50,000
		200,000
Net assets @ doa		
Shares	200,000	
Retained earnings	–	
		200,000
No Goodwill		–

Provision for Unrealised Profit calculation (PUP)

C	+	π	=	SP
100	+	25	=	?
			=	125

So 25/125 or 1/5 is the profit element
1/5 × 60,000 = 12,000 pup.
Reduce inventory and **SIGNE'S** retained earnings.

W3 Consolidated retained earnings

	Petras	Signe
Per question	300,000	150,000
Less pup		(12,000)
		138,000
Less pre acq		–
∴ post acq		138,000
P's share	103,500	75%
	403,500	

W4 Nci (25%)

Value @ doa	50,000
Share of post acq ret'd 25% x 138,000 (net of pup)	34,500
	84,500

Answers to Examples

Answer to Example 3

Linas Group Consolidated Statement of Financial Position as at 31 December, 2009.

		$'000
TNCA	(400 - 20 + 240 +10)	630
Current assets	(440 + 510)	950
		1,580
Shares	L Only	300
Retained earnings	(W3)	758
NC Interest	(W4)	292
		1,350
Current liabilities	(200 + 30)	230
		1,580

W1 L

60%

A —— 40%

W2 Goodwill

Cost		160,000
Nci investment valuation		158,000
		318,000
Net assets @ doa		
Shares	120,000	
Retained earnings	275,000	
		395,000
Goodwill		(77,000)

Pup calculation

Asset cost	200,000	
Acc dep	120,000	
	80,000	
Sold for		100,000
Pup of 20,000		
Dep for 2009	40,000	50,000
∴ excess dep is	10,000	

W3 Consolidated retained earnings

	Linas	Asta
Per question	500,000	600,000
Less pup	(20,000)	
Excess depreciation		10,000
	480,000	610,000
Less pre acq		(275,000)
∴ post acq		335,000
Linas's share	201,000	60%
	681,000	
Plus goodwill	77,000	
	758,000	

W4 NC Interest (30%)

Value @ doa	158,000
Share of S post acq ret'd 40% x 335,000	134,000
	292,000

Answer to Example 4

Laimonas Group Consolidated Statement of Financial Position

		$
INCA	(W2)	1,100
TNCA	(23 + 16)	39,000
Current assets	(36 + 64)	100,000
		140,100
Shares	L Only	60,000
Retained earnings	(W3)	38,040
NC Interest	(W4)	6,060
		104,100
Current liabilities	(9 + 10)	19,000
NCI prop div.		1,000
Proposed dividend	(for L)	16,000
		140,100

W1 L
| 90%
K —— 10%

W2 Goodwill

Cost of investment		50,000
Nci investment valuation		5,500
		55,500
Net assets @ doa		
Shares	20,000	
Retained earnings	30,000	
		50,000
Goodwill		5,500
Impaired since acquisition 80% x 5,500		(4,400)
CS of FP		1,100

W3 Consolidated retained earnings

	Laimonas	Kristine
per q	40,000	50,000
divs pble	(16,000)	(10,000)
divs rble	9,000	–
	33,000	40,000
less pre acq		30,000
∴ post acq		10,000
Laimonas' share	9,000	90%
	42,000	
Less: L's share of goodwill impairment 90% x 4,400	(3,960)	
	38,040	

W4 NC Interest (10%)

Value at doa	5,500
Share of S post acq ret'd 10% x 10,000	1,000
	6,500
Less goodwill impairment 10% x 4,400	(440)
on CSFP	6,060

Answers to Examples

Chapter 9

Answer to Example 1

Agne Group Consolidated Statement of Financial Position as at 31 August, 2009.

		$
INCA (W2)		51,250
TNCA (223 + 5 + 270 – 20)		478,000
Inventory (50 +62 – 4.5)		107,500
Receivables (60 –5 –12 + 48)		91,000
Cash (19 + 14 + 5)		38,000
		765,750
Shares		300,000
Premium		40,000
Consolidated retained earnings (W3)		172,160
NC Interest (W4)		75,790
		587,950
3% Debentures (40 + 100)		140,000
		727,950
Current Liabilities		
per q 12 + 20 – 12		20,000
A dividend payable		15,000
D div payable 28% × 10,000		2,800
		765,750

W1

A — 72% — 10m pre — 2m post

D — 28%

W2 Goodwill

Cost of investment		250,000
Nci investment valuation		87,667
		337,667
NA @ doa		
Shares	200,000	
Premium	10,000	
Profit b/f	40,000	
10 months profits (W2a)	19,333	
		269,333
		68,333
Impaired since acquisition		(17,083)
		51,250

W2a Profit split

for the year per question		24,000
Less TNCA profit		(20,000)
		4,000
Split 10 : 2	3,333	667
Profit on TNCA		20,000
fair value adjustment	16,000	(16,000)
	19,333	4,667

W3 Consolidated Retained Earnings

	Agne	*Dace*
Per question	210,000	64,000
Pup inventory/TNCA	(4,500)	(20,000)
XS depreciation	5,000	
Divs pble	(15,000)	(10,000
Divs rble (72% × 10,000)	7,200	–
	202,700	34,000
less pre acq		(59,333)
∴ Post-acq loss		(25,333)
A's share	(18,240)	72%
	184,460	
Less goodwill impairment 72% × 17,083	(12,300)	
	172,160	

W4 NC interest (28%)

Value @ doa	87,667
Share of S post acq ret'd 28% x (25,333)	(7,093)
	80,573
Less goodwill impairment 28% × 17,083	(4,783)
	75,790

Chapter 10

Answer to Example 1

Mantas Group Consolidated Statement of Comprehensive Income for the year ended 31 December, 2009.

		$
Revenue	(26 + 12)	38,000
Cost of sales and expenses	(10 + 7)	17,000
Profit before tax		21,000
Income tax expense	(6 +1.5)	7,500
Profit after tax		13,500 *
NCI 20% x 3,500		(700)
		12,800
Dividend Mantas only		5,000
		7,800

Proof

M own	7,000
+	
M's share of R's post acq ret'd 80% × 1,000	800
	7,800

* Of this amount, 700 relates to the NC interest and 12,800 relates to the members of Mantas.

Answer to Example 2

Lina Group Consolidated Statement of Comprehensive Income for the year ended 31 December, 2009.

		$
Revenue	(40 + 30 - 4)	66,000
Cost of sales and expenses	(27 + 16 - 4)	39,000
Profit before tax		27,000
Taxation	(4.8 +4.2)	9,000
Profit after tax		18,000 *

* Of this amount, 3,920 relates to the NC interest and 14,080 relates to the members of Lina

Statement of Changes in Equity

		Retained earnings	*NC interest*
Profit for the period		18,000	
NC Interest	40% × 9.8	(3,920)	3,920
		14,080	3,920
Dividend		(6,000)	(2,000)
		8,080	1,920
Proof			
Lina's own			5,200
+			
L's share of S's post acq ret'd 60% × 4,800			2,880
			8,080

* Of this amount, 3,920 relates to the NC interest and 14,080 relates to the members of Lina.

Answer to Example 3

Karolis Group Consolidated Statement of Comprehensive Income for the year ended 31 May, 2009.

		$
Revenue	(60 + 55 – 14)	101,000
Cost of sales and expenses	(32 + 30 – 14 + 1,867)	49,867
Profit before tax		51,133
Income tax expense	(10 + 7)	17,000
Profit after tax		34,133 *

* Of this amount, 8,100 relates to the non-controlling interest and 26,033 relates to the members of Karolis.

Statement of Changes in Equity

		Retained earnings	*NC interest*
Profit for the period		34,133	
NC Interest	45% × 18	(8,100)	8,100
		26,033	8,100
Dividend		(12,000)	(4,500)
		14,033	3,600
Proof			
K's own, per Q			11,500
Less pup			(1,867)
			9,633
+			
K's share of I's post acq ret'd 55% × 8,000			4,400
			14,033

Working

Pup on inventory

Cost	+	Profit	=	Selling Price
60	+	40	=	100

So profit on the transfer was 40% × 14,000 = 5,600
One third is still in inventory
So we need a pup of ⅓ × 5,600 in Karolis' Statement of Comprehensive Income ie 1,867
Reduce Karolis' inventory by 1,867 by increasing K's cost of sales and ∴ reduce K's profits.

Answer to Example 4

Viktorija Group Consolidated Statement of Comprehensive Income for the year ended 30 September, 2009.

		$	
Revenue	(90 + 100 - 30)	160,000	
Cost of sales and expenses	(32 + 40 - 30 + 2.7)	44,700	
Profit before tax		115,300	
Taxation	(20 + 18)	38,000	
Profit after tax		77,300	*

Statement of Changes in Equity

		Retained earnings	*NC interest*
Profit for the period		77,300	
NC Interest	40% × (42 - 2.7)	(15,720)	15,720
		61,580	15,720
Dividend		(30,000)	(8,000)
		31,580	7,720
Proof			
V's own			20,000
+			
V's share of N's post acq ret'd			
N per Q		22,000	
less: pup		2,700	
		19,300	
V's share		60%	11,580
			31,580

* Of this amount, 15,720 relates to the NC interest and 61,580 relates to the members of Viktorija.

Answer to Example 5

Didzis Group Consolidated Statement of Comprehensive Income for the year ended 30 June, 2009.

			$	
Revenue	(300 + 160)		460,000	
Cost of sales	(192 + 105 + 9,125)		306,125	
Gross profit			153,875	
Distribution costs	(18 + 10)	28,000		
Administrative expenses	(14 + 17)	31,000		
			59,000	
Profit before tax			94,875	
Income tax expense	(21 + 16)		37,000	
Profit after tax			57,875	*

* Of this amount, 3,000 relates to the non-controlling interest and 54,875 relates to the members of Didzis.

Statement of Changes in Equity

	Ret earnings	*Nci*	*Total*
brought forward (W3a)	160,875	14,250	175,125
this year	57,875		57,875
Nci share	(3,000)	3,000	
Dividend	(17,000)	(2,000)	(19,000)
	198,750	15,250	214,000

Answers to Examples

W1 Structure

D
|
| 75%
A —— 25%

W2 Goodwill

Cost of investment		65,000
Nci investment valuation		9,500
		74,500
Net assets @ doa		
Shares	20,000	
Retained earnings	18,000	
		38,000
Goodwill		36,500
Impaired b/f		(27,375)
Impaired this year		9,125

W3a Retained earnings brought forward

	Didzis	*Ansis*
per question	174,000	37,000
pre acq		(18,000)
post acq		19,000
D's share	14,250	75%
	188,250	
– goodwill impaired	27,375	
	160,875	

W3b Retained earnings carried forward

	Didzis	*Ansis*
per question	212,000	41,000
div rble	6,000	
– pre acq		(18,000)
post acq		23,000
D's share	17,250	75%
	235,250	
– goodwill impaired 100% D (nci valued on a proportionate basis)	36,500	
	198,750	

W4a Nci (25%) brought forward

Value @ doa	9,500
share of S post acq ret'd 25% x 19,000	4,750
	14,250

W4 Nci (25%)

Value @ doa	9,500
share of S post acq ret'd 25% x 23,000	5,750
	15,250

W4b NC interest (25%)

A's profit after tax	12,000
NC Interest share 25% × 12,000	3,000

Answer to Example 6

Lasma Group Consolidated Statement of Comprehensive Income for the year ended 31 August 2009

		$'000
Revenue	15,600 + 7/12 × 2,900	17,291.7
Cost of sales and expenses	8,400 + 7/12 × 1,300	9,158.3
Profit before tax		8,133.4
Income tax expense	2,000 + 7/12 × 420	2,245
Profit after tax		5,888.4 *

Statement of Changes in Equity

	Retained earnings	*NC Interest*
brought forward	6,500	
This year	5,888.4	
NC Interest	(68.8)	68.8
	12,319.6	68.8
Dividend	(1,700)	(12)
	10,619.6	56.8

Proof

L's own, per Q		10,000
Dividend from subsid	7/12 × 90% × 200	105
		10,105
+		
L's share of G's post acq ret'd	7/12 × 90% × 980	514.5
		10,619.5

* Of this amount, 68.8 (1,180 × 7/12 × 10%) relates to the non-controlling interest and 5,819.6 relates to the members of Lasma.

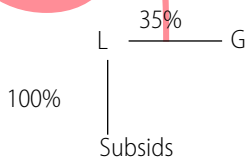
Chapter 11

Answer to Example 1

Laura Group Consolidated Statement of Financial Position as at 31 December, 2009.

	$
Investment in Associate (W5)	25,250
Other assets	180,000
Total assets	205,250
Shares	70,000
Retained earnings (W3)	120,250
	190,250
Liabilities	15,000
	205,250

W1



W3 Consolidated retained earnings

	Laura	*Gunta*
per question	115,000	18,000
– pre acq		(3,000)
∴ post acq		15,000
L's share	5,250	35%
	120,250	

Answers to Examples

W5A Investment in Associate

Cost	20,000
Share of post acq ret'd 35% (18 – 3)	5,250
	25,250

Answer to Example 2

Maris Group Consolidated Statement of Comprehensive Income for the year ended 31 December, 2009.

	$
Revenue	18,000
Cost of sales	(9,500)
Gross profit	8,500
Expenses	(2,900)
	5,600
Finance income	1,010
Finance cost	(700)
	5,910
Group's share of associate profit after tax (28% × 2,300)	644
Profit before tax	6,554
Taxation	2,000
Profit after tax	4,554

Statement of Changes in Equity

	Retained earnings
brought forward	?
This year	4,554
Dividend	1,500
carried forward	3,054

Proof

M's own per Q	2,410
Dividend from associate 28% × 400	112
	2,522
+	
M's share of G's post acq. 28% × 1,900	532
	3,054

Chapter 12

No examples

Chapter 13

Answer to Example 1

(a) At the end of year 1

If the contract is not sufficiently advanced that the outcome is capable of estimation with reasonable certainty, then the percentage completed will be applied to revenues and costs will be the same amount, thereby recognising no profit.

If the contract is sufficiently advanced (say 30%) then it would be appropriate to recognise 30% of the $1 million contract value and 30% of the total estimated costs

If the contract is so far advanced (say 57%) that the probability of earning the additional $300,000 is high, then there is a case for recognising also a proportion of the $300,000. It really would only be appropriate if the probability was "virtually certain". This may be viewed in either of two ways:

Either

57% × $1,300,000	741,000
Less 57% × total estimated costs	(x)
	?

or

57% × $1,000,000	570,000
+	
95% × $300,000	285,000
	855,000
Less 57% × total estimated costs	(x)
	?

The bonus of $100,000 would be ignored in all circumstances, until received on completion (if at all!)

(b) At the end of year 2

If the contract is not sufficiently advanced that the outcome is capable of estimation with reasonable certainty, then revenues and costs will be recognised but no profit.

If the contract is sufficiently advanced, (say 40%) then it would be appropriate to recognise 40% of the $1 million contract value and 40% of the total estimated costs.

If the contract is ≥ 60% advanced, (say 65%) then it would be appropriate to recognise 65% of $1 million plus 100% of $300,000, and 65% of total estimated costs.

The bonus of $100,000 would be ignored in all circumstances, until received on completion (if at all!)

Answer to Example 2

Statement of Comprehensive Income

		$
Revenue recognised	55% ×1,000,000	550,000
Costs recognised	(55% × (400,000 + 350,000)	412,500
Profit recognised		137,500

Statement of Financial Position

Costs to date	400,000
Attributable profit (from above)	137,500
	537,500
Less amounts invoiced	500,000
Amounts due from customers	37,500
Amounts invoiced	500,000
Amounts received	470,000
Amounts due from customers (Accounts Receivable)	30,000

Answer to Example 3

Statement of Comprehensive Income

			$
Revenue recognised 60% ×1,200,000			720,000
Costs recognised	– period specific	200,000	
	– general (60% ×850,000)	510,000	
			(710,000)
Profit recognised			10,000

Statement of Financial Position

Costs to date	750,000
Attributable profit (from above)	10,000
	760,000
Less amounts invoiced	790,000
Amounts due to customers	(30,000)
Amounts invoiced	790,000
Amounts received	700,000
Amounts due from customers (Accounts Receivable)	90,000

Answers to Examples

Answer to Example 4

Statement of Comprehensive Income

		$
Revenue recognised	(65% ×500,000)	325,000
Costs recognised (balancing figure)		(375,000)
Loss recognised		(50,000)
Statement of Financial Position		
Costs to date		300,000
Attributable loss (from above)		(50,000)
		250,000
Amounts invoiced		(270,000)
Amounts due to customers		(20,000)
Amounts invoiced		270,000
Amounts received		(240,000)
Amounts due from customers (Accounts Receivable)		30,000

Answer to Example 5

Statement of Comprehensive Income

	Year 1	*Year 2*	*Year 3*
	$	$	$
Revenue recognised	300,000	350,000	550,000
Costs recognised	(280,000)	(510,000)	(200,000)
Profit/(Loss) recognised	20,000	(160,000)	350,000
Statement of Financial Position			
Amounts due from customers			50,000
Amounts due from customers			50,000
Amounts due to customers	40,000	230,000	-

Workings

Statement of Comprehensive Income

		Year 1	*Year 2*	*Year 3*
		$	$	$
Revenue recognised		300,000	650,000	1,200,000
Costs recognised	– specific	(40,000)	(40,000)	(190,000)
	– general	(240,000)	(750,000)	(800,000)
Profit/(Loss) recognised		20,000	(140,000)	210,000
Statement of Financial Position				
Costs to date		340,000	540,000	990,000
Attributable profit (from above)		20,000	(140,000)	210,000
		360,000	400,000	1,200,000
Less amounts invoiced		390,000	610,000	1,150,000
Amounts due from/(to) customers		(30,000)	(210,000)	50,000
Amounts invoiced		390,000	610,000	1,150,000
Amounts received		400,000	630,000	1,100,000
		(10,000)	(20,000)	50,000

For the Statement of Comprehensive Income, the figures in the workings are cumulative. So, for each year's details, it is necessary to deduct the cumulative amount brought forward in order to arrive at the current year's figures.

Chapter 14

No examples

Chapter 15

Answer to Example 1

(a) Yes, a legal obligation under the purchase contract

(b)

Give notice, and buy the cloth for 2 more months and produce		Give notice, buy the cloth, and sell immediately		Cancel the contract without notice	
Cost 2 × 900 × $7	12,600	2 × 900 × $7	12,600	2 × $700	1,400
Labour cost 2 ×900/3 × $4	2,400				
	15,000				
Sell 2 × 300 dresses × $22	13,200	Sell 2 × 900 × $6.25	11,250		
Loss	(1,800)	Loss	(1,350)	Loss	(1,400)

There is therefore an unavoidable loss of $1,350. This should be provided for in the Statement of Financial Position and expensed through the Statement of Comprehensive Income. In the Notes to the Financial Statements, there should be an explanation of the circumstances and the uncertainties concerning timings, amounts and assumptions

Answer to Example 2

(a) There is neither a legal nor constructive obligation, because no obligating event has yet occurred. The directors could change their minds, and decide to keep the Kaunas factory open. Therefore, no provision is appropriate.

(b) There is a detailed plan, the impact of which has been communicated to suppliers and the workforce. Paulius has therefore raised the valid expectation in the minds of those affected. Although not a legal obligation, there is a constructive obligation arising from some past event, involving the probable outflow of economic resource. A provision is therefore appropriate in the amount which represents the best estimate of the costs of closing the Kaunas factory.

Answer to Example 3

If she has a 42% chance of losing, then she must have a 58% chance of winning. It is, therefore, not probable that she has an obligation. No provision would be appropriate.

However, there is a possible obligation, arising from some past event, which may involve the outflow of economic resource.

The appropriate treatment in Justina's financial statements for the year ended 31 August, 2009 would therefore seem to be to treat the matter as a contingent liability. This involves

- a disclosure note of the past event,
- the legal action outstanding,
- an explanation of the uncertainties upon which the outcome depends, and
- an estimate of the costs, were she to lose the case

Answer to Example 4

(a) $130,000 is a certain liability. It should be provided for on her Statement of Financial Position and expensed through the Statement of Comprehensive Income for the year ended 31 December, 2009.

(b) It is more likely than not that Seimas will pass the new legislation. When it is passed, Ginta will have to pay to clear her mining sites, so an outflow of economic resource will probably occur arising from some past event, her mining activities. A provision would therefore seem appropriate. If she is unable to measure reliably the probable cost, then the matter should be treated as a contingent liability.

(c) Ginta has no obligation here. If faced with costs necessary to change her mining processes, she has the option to cease her mining activities. Any estimate of costs involved in the change are irrelevant, since there is no obligation arising from a past event. Any obligation lies in the future, and provision should not be made for the costs of future events.

Answers to Examples

Chapter 16

Answer to Example 1

Fair value		17,500
Deposit		460
		17,040
yr 1 int		1,704
		18,744
1		3,500
		15,244
yr 2 int		1,524
		16,768
2		3,500
		13,268
yr 3 int		1,327
		14,595
3		3,500
		11,095
yr 4 int		1,110
		12,205
4		3,500
		8,705
yr 5 int		870
		9,575
5		3,500
		6,075
yr 6 int		607
		6,682
6		3,500
		3,182
yr 7 int		318
		3,500
7		3,500
		-

Answer to Example 3

Giedris

	14 ×1,500	21,000
Deposit		1,152
MLP		22,152
Fair value		16,000
Finance lease interest		6,152
1.1.09		
Fair value		16,000
Deposit		(1,152)
		14,848
Interest to 30.6.09	14,848 × 10% × 6/12	742
		15,590
Paid 30.6.09		1,500
		14,090
Interest to 31.12.09	14,080 × 10% × 6/12	705
		14,795
Paid 31.12.09		1,500

		13,295
Interest to 30.6.10	13,295 × 10% × 6/12	665
		13,960
Paid 30.6.10		1,500
		12,460
Interest to 31.12.10	12,460 × 10% × 6/12	623
		13,083
Paid 31.12.10		1,500
		11,583

Extracts from the Financial Statements
Statement of Financial Position

TNCA (16,000 – 2,286)	13,714
Long term liabilities	
Obligations under finance leases	11,583
Current liabilities	
Obligations under finance leases (13,295 – 11,583)	1,712

Statement of Comprehensive Income

	$
Depreciation (16,000 / 7)	2,286
Finance lease interest (742 + 705)	1,447

Notes
Accounting policy

Depreciation
Depreciation is charged on a straight line basis on tangible non-current assets in order to write them off over their estimated useful lives. In the case of assets acquired under finance lease, depreciation is charged in order to write off the asset over the lease term.

Finance lease interest
Finance lease interest is calculated using the rate of interest implicit in the lease.

	Asset held under finance lease
Non-current assets	
Cost brought forward	–
Additions	16,000
Disposals	–
Cost carried forward	16,000
Depreciation brought forward	–
Charge for the year	2,286
On disposals	–
Depreciation carried forward	2,286
Net book value at 31 December, 2009	13,714
Net book value at 1 January, 2009	–
Long term liabilities	
Obligations under finance leases falling due more than 12 months hence	11,583

Reconciliation of Obligations under Finance Leases with the present value of the minimum lease payments

	gross	*or*	*net*
Payable within 1 year	3,000		2,790
Payable more than 1 year, less than 5 years	12,000		8,793
Payable more than 5 years	3,000		1,712
	18,000		
Less: finance lease interest not yet accrued	4,705		
	13,295		13,295

Answers to Examples

Giedruola

Fair value	16,000
Deposit	1,910
	14,090
Interest to 30.6.09	705
	14,795
Paid 1.7.09	1,500
	13,295
Interest to 31.12.09	665
	13,960
Paid 1.1.10	1,500
	12,460
Interest to 30.6.10	623
	13,083
Paid 1.7.10	1,500
	11,583
Interest to 31.12.10	579
	12,162
Paid 1.1.11	1,500
	10,662

Extracts from the Financial Statements

Statement of Financial Position

TNCA	(16,000 – 2,286)	13,714
Long term liabilities		
Obligations under finance leases		11,583
Current liabilities		
Obligations under finance leases	(13,295 – 11,583)	1,712
Finance lease interest accrued		665

Statement of Comprehensive Income

		$
Depreciation	(16,000 / 7)	2,286
Finance lease interest	(705 + 665)	1,370

Notes

Accounting policy	- same as Giedris
TNCA	- same as Giedris

Long term liabilities

Obligations under finance leases falling more than 12 months hence	11,583

Reconciliation of Obligations under Finance Leases with the present value of the minimum lease payments

Obligations under finance leases

	gross	*or*	*net*
Payable within 1 year	3,000		2,790
Payable more than 1 year, less than 5 years	12,000		8,793
Payable more than 5 years	3,000		1,712
	18,000		
Less: finance lease interest not yet accrued	4,705		
	13,295		13,295

Chapter 17

Answer to Example 1

Date	*Cumulative Borrowing*	*Invested*	*Spent*
	$M	*$M*	*$M*
1.1.08	100	50	50
28.2.08		20	30
1.4.08	220	90	50
31.5.08		30	60
31.8.08	300	90	20
1.11.08	work suspended		
1.1.09	work restarted	-	90
28.2.09	work completed		

Cost of completing the project				300,000,000
Borrowing costs				
January to March	$100 \times 3/12 \times 0.07$	1,750,000		
April to August	$220 \times 5/12 \times 0.07$	6,416,666		
September to October	$300 \times 2/12 \times 0.07$	3,500,000		
January to February	$300 \times 2/12 \times 0.07$	3,500,000		
			15,166,666	
Investment income				
January to February	$50 \times 2/12 \times 0.05$	416,666		
March	$20 \times 1/12 \times 0.05$	83,333		
April to May	$90 \times 2/12 \times 0.05$	750,000		
June to August	$30 \times 3/12 \times 0.05$	375,000		
September to October	$90 \times 2/12 \times 0.05$	750,000		
			2,375,000	
Capitalised borrowing costs				12,791,666
Carrying value immediately before sale				$312,791,666

Chapter 18

Answer to Example 1

	2009	*2010*
	$ '000	*$ '000*
Profit from operations	700	700
Royalty receivable	60	–
Profit	760	700
Tax – current	(175)	(190)
– deferred	(15)	15
Profit after tax	570	525
Deferred tax liability	15	–

Answer to Example 2

	2009	*2010*	*2011*	*Total*
	$	*$*	*$*	*$*
Profit before depreciation	1,800,000	2,300,000	2,500,000	6,600,000
Depreciation	(200,000)	(200,000)	(200,000)	(600,000)
Profit	1,600,000	2,100,000	2,300,000	6,000,000
Tax – current (WI)	300,000	575,000	625,000	1,500,000
– deferred (W2)	100,000	(50,000)	(50,000)	-
	1,200,000	1,575,000	1,725,000	4,500,000
Deferred tax liability	100,000	50,000	-	

The temporary difference in this example is the difference between the carrying value of the asset (net book value) and its tax written down value after deducting the tax allowances.

(W1) Income Tax working

	2009	2010	2011
	$	$	$
Profit before depreciation	1,800,000	2,300,000	2,500,000
Tax allowances	600,000	-	-
	1,200,000	2,300,000	2,500,000
At 25%	300,000	575,000	625,000

(W2) Deferred tax working

Book value	400,000	200,000	–
Tax written down value	–	–	–
	400,000	200,000	–
At 25%	100,000	50,000	–

Answer to Example 3

Revaluation	Carrying value	342,000	
	Revalued to	600,000	
		258,000	
	less deferred tax	37,500	
	Revaluation reserve	220,500	
Deferred tax	Revalued amount	600,000	
	Tax written down value	450,000	
	Temporary difference	150,000	
	@ 25%	37,500	Deferred tax

Answer to Example 4

	2009	2010
	$'000	$'000
Profit from operations	660	660
Warranties	(160)	-
	500	660
Tax – current	165	125
– deferred	(40)	40
Profit after tax	375	495
Deferred tax asset	40	-

The temporary difference is equivalent to the difference between the Statement of Financial Position accrual for warranties and the tax base of the warranty payments liability which is nil in 2009, because nothing has yet been paid.

Chapter 19

Answer to Example 1

T Accounts

PPE A/c			
b/f	960	Disposals	110
Revaluation	250		
Therefore cash	220	c/f	1,320
	1,430		1,430

PPE Acc Dep A/c

		b/f	390
Disposals	70		
c/f	520		
		Therefore dep.	200
	590		590

Disposals A/c

Cost of disposals	110	Dep on disposals	70
		Proceeds	47
∴ Gain on disposals	7		
	117		117

Schedules

Cost

Brought forward	960,000
Increased by revaluation	250,000
	1,210,000
Decreased by disposal	110,000
	1,100,000
Carried forward	1,320,000
Therefore purchased	220,000

Depreciation

Brought forward	390,000
Decreased by disposal	70,000
	320,000
Carried forward	520,000
Therefore charge for year	200,000

Disposal

Net book value disposed of	40,000
Proceeds	47,000
Therefore profit on disposal	7,000

Statements of Cash Flows extracts

Operating activities

Add back depreciation	200
Less profits on disposal	(7)

Investing activities

Purchases of property, plant and equipment	(220)
Proceeds of sale of property, plant and equipment	47

Answer to Example 2

Share Capital A/c

		b/f	35,000
		Bonus	5,000
c/f	58,000	Therefore new issue	18,000
	58,000		58,000

Share Premium A/c

		b/f	17,600
c/f	29,700	Therefore new issue	12,100
	29,700		29,700

Schedules

Share capital

Brought forward	35,000
Increased by bonus issue	5,000
	40,000
Carried forward	58,000
Therefore new issue	18,000

Share premium

Brought forward	17,600
Carried forward	29,700
Therefore premium on new issue	12,100

Cash proceeds from the issue of shares is therefore 18,000 + 12,100 ie $30,100

Answer to Example 3

Int Payable A/c

Therefore cash	273,000	b/f	74,000
c/f	18,000	SOCI	217,000
	291,000		291,000

Obligations under finance leases A/c

Cash paid	9,000	Fair value	?
		Finance lease interest	1,800
c/f	?		

Finance lease interest A/c

Transfer from Obligations a/c	1,800	SOCI	1,800

Schedules

Interest

Int liability b/f	74,000
Statement of Comprehensive Income - interest for the year	217,000
	291,000
less liability c/f	18,000
Therefore paid	273,000

Obligations

Fair value b/f	?
Reduced by (incorrectly)	9,000
	?
Add back the interest element	1,800
Obligations c/f	?

Statement of Cash Flows extracts

Operating activities	
Add back interest charged	217,000
Less interest paid	(273,000)
Finance lease interest paid	(1,800)
Financing activities	
Obligations under finance leases paid	(7,200)

Answer to Example 4

Taxation A/c

Therefore paid	430	b/f	420
		SOCI	400
c/f	390		
	820		820

Schedules	
Taxation liability b/f	420
Increased by charge for the year	400
	820
less liability c/f	390
Therefore paid	430

Answer to Example 5

Dividend payable A/c

paid	831	b/f	831
paid	600	SOCI	1,515
c/f	915		
	2,346		2,346

Schedule	
Dividend liability b/f	831
Increased by interim dividend	600
Increased by final dividend	915
	2,346
less liability c/f	915
	1,431

Answer to Example 6

Zita Statement of Cash Flows for the year ended 31 December, 2009

	$'000	*$'000*
Cash flows from operating activities		
Net profit before taxation		723
Add back depreciation		50
amortisation		43
interest charge		110
movement in provision		23
loss on disposal of assets		6
Operating profit before working capital changes		955
Decrease in inventory	82	
Increase in receivables	(32)	
Decrease in payables	(12)	
		38
Cash generated from operations		993
Interest paid	(40)	
Dividend paid	(140)	
Taxation paid	(228)	
		(408)

Net cash flow from operating activities		585
Cash flows from investing activities		
Purchase of TNCA	(200)	
Purchase of INCA	(641)	
Proceeds of asset disposal	103	
Purchase of investments	(239)	
Net cash flow from investing activities		(977)
Cash flows from financing activities		
Proceeds of share issue (125 + 103)	228	
Proceeds of debenture issue	132	
Net cash flow from financing activities		360
Net decrease in cash and cash equivalents		(32)
Cash and cash equivalents at start of the year		81
Cash and cash equivalents at end of the year (17 + 32)		49

Note 1 Property, plant and equipment

During the year, the entity bought property, plant and equipment at a cost of $200,000. There were no acquisitions in the year under finance lease agreements.

Note 2 Cash and cash equivalents

Cash and cash equivalents comprise cash in hand, balances at banks and investments in Treasury Bills. The figure for cash and cash equivalents in the Statement of Cash Flows comprises the following Statement of Financial Position amounts:

	2009	*2008*
	$'000	*$'000*
Cash in hand and balances with banks	17	81
Investment in Treasury Bills	32	–
Cash and cash equivalents	49	81

Answer to Example 7

(a) Indirect method

		$'000
Profit before tax		430
Add back depreciation		84
Less profit on disposal of asset		(15)
		499
Changes in working capital		
Increase in inventory	(129)	
Decrease in receivables	134	
Decrease in payables	(72)	
		(67)
Net cash flow from operating activities		432

(b) Direct method

Cash received from customers (W1)	3,050
Cash paid to suppliers and for expenses (W2)	(2,495)
	555
Cash paid to employees	(123)
Net cash flow from operating activities	432

Workings

W1 Cash received from customers

Receivables A/c

b/f	625	Bad debts	17
Sales	2,933	c/f	491
		∴ Cash	3,050
	3,558		3,558

Schedule

Receivables b/f	625
Increased by sales	2,933
	3,558
Reduced by bad debt w/o	17
	3,541
Receivables c/f	491
Therefore cash received	3,050

W2 Cash paid to suppliers for goods and expenses

First we need to find cost of goods purchased by reconstructing the cost of sales figure

Opening inventory	518
Purchases	?
	2,395
Less closing inventory	(647)
Cost of sales	1,748

Purchases of goods is therefore	1,877

Payables A/c

		b/f	401
Therefore cash	2,495	purchases	1,877
		admin W3	108
c/f	329	distribution	438
	2,824		2,824

Schedule

b/f	401
Increased by goods purchased	1,877
Admin costs	108
Distribution costs	438
	2,824
c/f	(329)
	2,495

W3 Administrative expenses

per Q	317	
less depreciation	84	not cash
	233	
less employee costs	123	shown separately
	110	
less bad debts w/o	17	not cash
	93	
add back profit on asset disposal	15	not cash
	108	

Chapter 20

Answer to Example 1

Benefits for users of Financial Statements from ratio analysis:

(a) Shareholders
- assess management performance
- use the results when making a decision to buy, or sell, shares in the entity
- compare the return on their investment with some benchmark, for example the rate of interest offered by banks

(b) Potential investors
- identify a better yield were they to invest in the entity as compared with any current yield which they are at present enjoying
- see the opportunity for acquisition of the entity in order to achieve a greater market share, or enjoy economies of scale

(c) Banks and other capital providers
- assess financial strength
- decide whether the entity is capable of servicing existing, or increased, levels of loans and borrowings

(d) Employees
- assess the results of their efforts
- use the ratios as a basis for rate of pay negotiations

(e) Management
- identify areas where improvements could be made
- use the ratios to defend against rate of pay increases!
- compare their own performance with the industry average or with the performance of competitors

(f) Suppliers
- decide whether to advance further credit to the entity
- assess whether the entity is a going concern

(g) Government
- use the results for statistical purposes
- determine whether, for example, the tax revenues from the entity are realistic.

Answer to Example 2

To: Elchin
From: Ann Alyste
Date: 23 February 2010

Subject: Analysis of Aurelija's Financial Statements 2008 and 2009

1 Introduction

1.1 This report analyses, with the use of ratios, the performance and financial position of Aurelija. Ratio calculations can be found in the Appendix to this report.

2 Profitability

2.1 Whereas revenue has increased by 22%, and profit margin has been improved by almost 24% from 7.6% to 9.4%, the figures are not in themselves particularly useful because they are so small

2.2 A Return on Capital Employed which has improved by more than 50% has to be seen in the light of the fact that it is still less than 1% of the assets available to Aurelija.

2.3 Asset turnover also shows an improvement of 21%, but an ability to turn assets over fewer than once every 14 years is not normally an indication of efficient management.

3 Efficiency

3.1 It is generally accepted that a current ratio of 2:1 is, dependent upon the nature of the industry in which the entity operates, a sign of reasonable liquidity and efficiency. Unless Aurelija is, for example, a supermarket with fast turnover and no receivables, the current ratio of ·6:1 must be considered potentially as a sign of poor liquidity, particularly when compared with the 2008 position of 1.5:1

3.2 As a measure of short term liquidity, the fall in the quick ratio from (almost) parity to ·3:1 is a further cause for concern, even more so in light of the fact that Aurelija raised $200,000 during the year by way of debenture issue.

3.3 Inventory/turnover has fallen from a respectable 6.3 times (just under 2 months) to a disappointing 4 times (every 3 months). Instead of having 6 opportunities each year to sell goods and make profits, this has fallen to just 4 opportunities.

3.4 The receivables collection period has increased alarmingly, from 46 days to 84 days. It may be that Aurelija has accumulated

some doubtful debts, which should be written off, or it may indicate a change in the mixture of cash and credit sales.

3.5 Whatever the cause, when combined with the inventory turnover ratio, Aurelija is only able to collect cash from inventory after (91 + 84) 175 days or 6½ months. (2008 104 days, 3½ months)

3.6 Meanwhile, in acquiring that inventory, Aurelija is paying the suppliers within 176 days, compared with just 80 days in 2008.

3.7 All the above points suggest that Aurelija is suffering major cash flow problems, and could experience difficulty in the future buying goods from suppliers at competitive prices.

4 Debt and financing

4.1 Aurelija has borrowed $200,000 in 2009, accounting for 2/3 of the interest charge in the Statement of Comprehensive Income. In addition, the bank position has deteriorated by $409,000, and $280,000 has been "borrowed" from suppliers

4.2 It is not apparent from the financial statements (without a Statement of Cash Flows for the year) to see where this $889,000 has been used.

4.3 Clearly only very little, if any, has been invested in new property, plant and equipment, but it does seem that a new car has been purchased!

5 Other matters

5.1 Distribution costs as a percentage of revenue have decreased from 9% to 8.6%, and administrative expenses have risen from 7.4% of revenue to just over 8%. It would be interesting to identify the causes of these variations.

5.2 The dividend policy appears to be consistent in that 37% of profits available are distributed in both years.

6 Conclusion

6.1 Unless Aurelija is in a highly competitive industry/market, the initial impression is one of major underachievement. If Aurelija were to close operations, and invest the proceeds in the bank, it would probably achieve a return of 4% net on $16,000, a return of $640 compared with $64 in 2009 and $54 in 2008.

6.2 Further investigation is required in areas such as the age of tangible non-current assets, nature of the industry and Aurelija's position within the industry, but on the surface this does not look to be a good entity to invest in.

Appendix

	2009		*2008*	
Return on capital employed	$\frac{115}{16,248}$	0.75%	$\frac{76}{16,008}$	0.48%
Profit margin	$\frac{115}{1,220}$	9.4%	$\frac{76}{1,000}$	7.6%
Asset turnover	$\frac{1,220}{16,248}$	0.075%	$\frac{1,000}{16,008}$	0.062%
Return on equity	$\frac{64}{16,048}$	0.40%	$\frac{54}{16,008}$	0.34%
Current ratio	520 : 872	.6 : 1	310 : 202	1.5 : 1
Quick ratio	295 : 872	.3 : 1	190 : 202	.95 : 1
Inventory turnover	$\frac{900}{225}$	4 ×	$\frac{760}{120}$	6.3 ×
Receivables days	$\frac{280 \times 365}{1,220}$	83.7 days	$\frac{125 \times 365}{1,000}$	46 days
Payables days	$\frac{440 \times 365}{900}$	176 days	$\frac{160 \times 365}{760}$	80 days
Debt / equity	$\frac{200}{16,048}$	1.25%		N/A
Interest cover	$\frac{115}{24}$	4.87 ×		N/A
Dividend cover	$\frac{64}{24}$	2.7	$\frac{54}{20}$	2.7

Answers to Examples

Chapter 21

Answer to Example 1

Rights fraction

	Shares	*Value*	*Investment*
Before	4	4	16
Rights	1	3	3
After	5		19

After the rights issue, an existing investor has an investment of 5 shares worth $19 ie $3.80 per share.

The rights fraction is therefore $\frac{\text{CRAP}}{\text{TERP}}$ ie $\frac{4.00}{3.80}$

Do not reduce this to a decimal calculation. A degree of accuracy is unnecessarily lost.

Basic EPS calculation

Date	*Number*	*Period*	*Fraction*	*WANES*
1.1.09	5,000,000	7/12	4/3.8	3,070,175
1.8.09	6,250,000	5/12		2,604,166
				5,674,341

EPS $\frac{3{,}000{,}000}{5{,}674{,}341} = 52.9c$

2008 as originally disclosed 54c

as restated $\frac{54 \times 3.8}{4} = 51.3c$

Answer to Example 2

Date	*Number*	*Period*	*Fraction*	*WANES*
1.3.08	2,000,000	6/12	9/7	1,285,714
31.8.08	5,000,000	2/12	9/7	1,071,428
1.11.08	6,428,571	4/12		2,142,857
				4,500,000

Basic EPS $\frac{600{,}000}{4{,}500{,}000} = 13.3c$

Last year, as originally disclosed 16c

as restated 12.4c

Answer to Example 3

Basic EPS $\frac{2{,}800{,}000}{4{,}000{,}000} = 70c$

Diluted

	3,000,000	@ 4	12,000,000
	2,400,000	@ 5	12,000,000
Therefore	600,000	@ NIL	

It is only these 600,000 free shares which are considered in the diluted eps calculation

	shares	*earnings*
existing	4,000,000	2,800,000
options	600,000	–
Therefore	4,600,000	2,800,000

So diluted EPS is $\frac{2{,}800{,}000}{4{,}600{,}000} = 60.9c$

Answer to Example 4

Basic $\frac{700{,}000}{2{,}000{,}000}$ = 35 basic eps

Diluted

Potential equity shares (the worst position)

$\frac{3{,}000{,}000}{1{,}000} \times 760 = 2{,}280{,}000$ Pes

Potential extra earnings

3,000,000 × 6.25% × .75 = $140,625 Pee

Diluted calculation $\frac{700{,}000 + 140{,}625}{2{,}000{,}000 + 2{,}280{,}000}$ = 19.64c

Answer to Example 5

Basic eps $\frac{10{,}000{,}000}{3{,}370{,}000}$ = $2.97

Dilution workings

520,000 options

520,000	@ 3		1,560,000
390,000	@ 4		1,560,000
130,000		free Pes and no Pee	

2,000,000 options

Ignore, because the exercise price is greater than the mid-market price, so no director would exercise their right to buy at $5 when they could buy the shares on the market for $4!

$20,000,000 10% convertible bonds

Pes $\frac{20{,}000{,}000}{1{,}000} \times 30 = 600{,}000$ Pes

Pee 10.673% × 20,000,000 × .75 = $1,600,950 Pee

	Pes	*Pee*	*Meps*	*Rank*
Options	130,000	–	–	①
Bonds	600,000	1,600,950	2.67	②

Working to find diluting instruments

	shares	*earnings*	*Eps*	
	3,370,000	9,100,000	$2.70	control figure
options	130,000	–		
	3,500,000	9,100,000	$2.60	
bonds	600,000	1,600,950		
	4,100,000	10,700,950	$2.61	*

* when the bonds are converted, eps improves from $2.60 to $2.61. The bonds are, therefore, anti-dilutive, and should be ignored in the final calculation

Final working

	shares	*earnings*	*Eps*
existing	3,370,000	10,000,000	
options	130,000	–	
	3,500,000	10,000,000	$2.86

The disclosed diluted eps will therefore be $2.86

Answers to Examples

Chapter 22

No Examples

Chapter 23

No Examples

Chapter 24

No Examples

Chapter 25

No Examples

Chapter 26

No Examples

Chapter 27

No Examples

Chapter 28

Answer to Example 1

	Carrying Value at start		*Interest 10% IRR*		*Subtotal*		*Payment 6%*		*Carrying value*
2009	314,354	+	31,435	=	345,789	-	21,600	=	324,189
2010	324,189	+	32,419	=	356,608	-	21,600	=	335,008
2011	335,008	+	33,501	=	368,509	-	21,600	=	346,909
2012	346,909	+	34,691	=	381,600	-	21,600	=	360,000
Total charged to Statement of Comprehensive Income over 4 years			132,046						

The initial entries in James' records would be:

DR	Cash	314,354	
CR	Bond liability		314,354

Answer to Example 2

(i)

			$	$
	DR	Cash (300,000 × 10c)	30,000	
	CR	Warrants		30,000
(ii)	DR	Cash (250,000 × 1.40c)	350,000	
	DR	Warrants (250,000 × 10c)	25,000	
	CR	Equity share capital		250,000
	CR	Share premium		125,000
	DR	Warrants	5,000	
	CR	Retained earnings		5,000

Answer to Example 3

To arrive at the solution, we need to value either the debt element or the equity element. Since it is not possible, from the information given, to value the equity element (we do not know a market price for the shares) we must instead find the present value of the debt. This comprises not just capital but also the interest payments.

		DF	*year*	
8,000,000 @ 8%	640,000	.909	2009	581,818
	640,000	.826	2010	528,925
	640,000	.751	2011	480,841
	640,000	.683	2012	437,129
	640,000	.621	2013	397,390
	8,000,000	.621	2013	4,968,000
Present value of debt component				7,394,103
Total value of bond				8,000,000
... Equity component				$605,897

Paper F7

MINI EXERCISES – QUESTIONS

1 Cost of Sales

Question 1

A butcher sells $300,000 of meat at a consistent mark up of 25%. His inventory at the start of the year was $15,000. This had increased by 20% by the end of the year.

Calculate the purchases for the year.

Question 2

His rival down the road achieves a gross margin of 15%. His closing inventory was 30% higher than the opening inventory. Sales in the year were $450,000 and purchases were $400,000.

What was the opening inventory?

Question 3

The local supermarket sold $500,000 worth of goods in January at a consistent mark up of 12½%. Opening inventory was $20,000 and purchases in the month were $440,000.

How much was closing inventory?

2 Intra-group pup

Calculate the pup, state in whose books and show the journal entry.

H = holding company; S = subsidiary; A = associate

in all cases; H own 60% of S and 30% of A

1 H sold $60,000 goods to S at a mark up of 20%.
S had sold one third of these goods by the end of the year

2 S sold $40,000 goods to H at a gross margin of 25%
H had sold one quarter of these goods by the end of the year

3 H sold $80,000 goods to A at a gross profit of 30%
A had sold none of these goods by the end of the year

4 S sold $ 70,000 goods to A at a mark up of 20%
A had sold $4,000 of these goods by the end of the year

5 A sold $100,000 goods to H at a mark up of 30%
H had sold 60% of these goods by the end of the year

6 A sold $ 30,000 goods to S at a gross margin of 40%
S had sold none of these goods by the end of the year

7 H sold $20,000 goods to S at a gross margin of 25%
S had sold all of these goods by the end of the year

8 S sold $16,500 goods to A at a mark up of 10%
A had sold $11,000 of these goods by the end of the year

9 S sold $90,000 goods to H at a mark up of 30%
H had sold all of these goods by the end of the year

10 A sold $22,000 goods to S at a mark up of 40%
S had sold 40% of these goods by the end of the year

Mini Exercises – Questions

3 Goodwill calculations

Question 1

H acquired 70% of the 800,000 $1 shares in S for $900,000. At that date the S retained earnings were $400,000.

Calculate the goodwill in the following situations:

a) the directors have valued the investment of the nci in the shares of S at $380,000

b) the value of the S shares immediately before the H acquisition was $1.60

c) the directors have determined the value of the nci investment to be the same as their proportionate share of the S fair valued net assets

Question 2

H acquired 80% of the 1,000,000 $1 shares in S for $1,300,000. At that date the S retained earnings were $500,000.

Calculate the goodwill in the following situations:

a) the directors have valued the investment of the nci in the shares of S at $310,000

b) the value of the S shares immediately before the H acquisition was $1.58

c) the directors have determined the value of the nci investment to be the same as their proportionate share of the S fair valued net assets

Question 3

H acquired 75% of the 600,000 50c shares in S for $350,000. At that date the S retained earnings were $100,000.

Calculate the goodwill in the following situations:

a) the directors have valued the investment of the nci in the shares of S at $110,000

b) the value of the S shares immediately before the H acquisition was 70c

c) the directors have determined the value of the nci investment to be the same as their proportionate share of the S fair valued net assets

4 Goodwill – impairments

Question 1

H acquired 60% of the 500,000 $1 shares in S for $470,000. At that date the S retained earnings were $200,000. Goodwill has been impaired by 40%.

Calculate the goodwill figure which will appear on the Statement of Financial Position in the following situations:-

a) the directors have valued the investment of the nci in the shares of S at $305,000

b) the value of the S shares immediately before the H acquisition was $1.50

c) the directors valued the goodwill attributable to the nci at $15,000

d) the directors have determined the value of the nci investment to be the same as their proportionate share of the S fair valued net assets

Question 2

H acquired 55% of the 600,000 50c shares in S for $420,000. At that date the S retained earnings were $400,000. Goodwill has been impaired by 60%.

Calculate the goodwill figure which will appear on the Statement of Financial Position in the following situations:-

a) the directors have valued the investment of the nci in the shares of S at $340,000

b) the value of the S shares immediately before the H acquisition was $1.20

c) the directors valued the goodwill attributable to the nci at $10,000

d) the directors have determined the value of the nci investment to be the same as their proportionate share of the S fair valued net assets

Question 3

H acquired 80% of the 1,000,000 25c shares in S for $350,000. At that date the S retained earnings were $100,000. Goodwill has been impaired by 50%.

Calculate the goodwill figure which will appear on the Statement of Financial Position in the following situations:-

a) the directors have valued the investment of the nci in the shares of S at $85,000

b) the value of the S shares immediately before the H acquisition was 40c

c) the directors valued the goodwill attributable to the nci at $13,000

d) the directors have determined the value of the nci investment to be the same as their proportionate share of the S fair valued net assets

Mini Exercises – Questions

5 Excess depreciation & pup

Question 1

H sold some land to S recognising a profit of $40,000

What adjustment is needed on consolidation and in whose records?

Question 2

During the year S sold some PPE to H for $65,000. It had cost $100,000 when new, 4 years ago and its useful life of 9 years had not changed. Estimated scrap proceeds of $10,000 were revised on transfer to H to $20,000. It is group policy to charge depreciation on a straight line basis with a full year's charge in the year of purchase and none in the year of sale.

Calculate the adjustments necessary on consolidation, and identify in which company's records those adjustments should be.

6 Non current assets

For the following questions calculate the extracts where relevant from the Statement of Income and the Statement of Financial Position

Question 1

Trial balance extracts for year ended 31 March, 2011

Land and buildings at cost	270,000
Plant at cost	156,000
Accumulated depreciation to 31 March 2010	
Building	60,000
Plant	26,000
Rental of leased plant	22,000

The land and buildings were purchased on 1 April 1995. The cost of the land was $70 million. No land and buildings have been purchased by Kala since that date. On 1 April 2010 Kala had its land and buildings professionally valued at $80 million and $175 million respectively. The directors wish to incorporate these values into the financial statements. The estimated life of the buildings was originally 50 years and the remaining life has not changed as a result of the valuation.

Later, the valuers informed Kala that investment properties of the type Kala owned had increased in value by 7% in the year to 31 March 2011.

Plant, other than leased plant (see below), is depreciated at 15% per annum using the reducing balance method. Depreciation of buildings and plant is charged to cost of sales.

On 1 April 2010 Kala entered into a lease for an item of plant which had an estimated life of five years. The lease period is also five years with annual rentals of $22 million payable in advance from 1 April 2010. The plant is expected to have a nil residual value at the end of its life. If purchased this plant would have a cost of $92 million and be depreciated on a straight-line basis. The lessor includes a finance cost of 10% per annum when calculating annual rentals. (Note: you are not required to calculate the present value of the minimum lease payments.)

Question 2

Trial balance extracts for year ended 30 September, 2008

Land and buildings at valuation 10 October, 2007	130,000
Plant at cost	128,000
Accumulated depreciation to 31 March 2007	
Plant	32,000
Investments at fair value through profit and loss	26,500

Llama has a policy of revaluing its land and buildings at each year end. The valuation in the trial balance includes a land element of $30 million. The estimated remaining life of the buildings at that date (1 October 2007) was 20 years. On 30 September 2008, a professional valuer valued the buildings at $92 million with no change in the value of the land. Depreciation of buildings is charged 60% to cost of sales and 20% each to distribution costs and administrative expenses.

During the year Llama manufactured an item of plant that it is using as part of its own operating capacity. The details of its cost, which is included in cost of sales in the trial balance, are:

	$,000
Materials cost	6,000
Direct labour cost	4,000
Machine time cost	8,000
Directly attributable overheads	6,000

The manufacture of the plant was completed on 31 March 2008 and the plant was brought into immediate use, but its cost has not yet been capitalised.

All plant is depreciated at 12½ % per annum (time apportioned where relevant) using the reducing balance method and charged to cost of sales. No non-current assets were sold during the year.

The fair value of the investments held at fair value through profit and loss at 30 September 2008 was $27.1 million.

Mini Exercises – Questions

Question 3

Draft financial statements extracts as at 31 March, 2009.

Property at valuation	
Land	20,000
Buildings	165,000
Plant	180,500
Investments at fair value through profit and loss at 31 March, 2008	12,700

The non-current assets have not been depreciated for the year ended 31 March 2009.

Dexon has a policy of revaluing its land and buildings at the end of each accounting year. The values in the above statement of financial position are as at 1 April 2008 when the buildings had a remaining life of fifteen years. A qualified surveyor has valued the land and buildings at 31 March 2009 at $180 million.

Plant is depreciated at 20% on the reducing balance basis.

The investments at fair value through profit and loss are held in a fund whose value changes directly in proportion to a specified market index. At 1 April 2008 the relevant index was 1,200 and at 31 March 2009 it was 1,296.

Question 4

Trial balance extracts at 30 September, 2009

Leasehold property at valuation on 30 September 2008	50,000
Plant and equipment at cost	76,600
Accumulated depreciation at 30 September, 2008	
Plant	24,600
Capitalised development expenditure at 30 September, 2008	6,000

Non-current assets – tangible:

The leasehold property had a remaining life of 20 years at 1 October 2008. The company's policy is to revalue its property at each year end and at 30 September 2009 it was valued at $43 million. Ignore deferred tax on the revaluation.

On 1 October 2008 an item of plant was disposed of for $2.5 million cash. The proceeds have been treated as sales revenue by Candel. The plant is still included in the above trial balance figures at its cost of $8 million and accumulated depreciation of $4 million (to the date of disposal).

All plant is depreciated at 20% per annum using the reducing balance method.

Depreciation and amortisation of all non-current assets is charged to cost of sales.

Non-current assets – intangible:

In addition to the capitalised development expenditure (of $20 million), further research and development costs were incurred on a new project which commenced on 1 October 2008. The research stage of the new project lasted until 31 December 2008 and incurred $1.4 million of costs. From that date the project incurred development costs of $800,000 per month. On 1 April 2009 the directors became confident that the project would be successful and yield a profit well in excess of its costs. The project is still in development at 30 September 2009.

Capitalised development expenditure is amortised at 20% per annum using the straight-line method. All expensed research and development is charged to cost of sales.

Question 5

Trial balance extracts at 31 March, 2010

Leasehold property at valuation on 31 March, 2009	25,200
Plant and equipment (owned) at cost	46,800
Plant and equipment (leased) at cost	20,000
Accumulated depreciation at 31 March 2009	
Owned plant and equipment	12,800
Leased plant and equipment	5,000
Finance lease payment (paid on 31 March, 2010)	6,000
Obligations under finance lease at 31 March, 2009	15,600

Non-current assets:

The 15 year leasehold property was acquired on 1 April 2008 at cost $30 million. The company policy is to revalue the property at market value at each year end. The valuation in the trial balance of $25.2 million as at 31 March 2009 led to an impairment charge of $2.8 million which was reported in the income statement of the previous year (ie year ended 31 March 2009). At 31 March 2010 the property was valued at $24.9 million.

Owned plant is depreciated at 25% per annum using the reducing balance method.

The leased plant was acquired on 1 April 2008. The rentals are $6 million per annum for four years payable in arrears on 31 March each year. The interest rate implicit in the lease is 8% per annum. Leased plant is depreciated at 25% per annum using the straight-line method.

No depreciation has yet been charged on any non-current assets for the year ended 31 March 2010. All depreciation is charged to cost of sales.

7 Loan interest / preference dividends

For the following questions calculate the extracts where relevant from the Statement of Income and the Statement of Financial Position

Question 1

Trial balance extracts at 31 March, 2007

8% (actual and effective) loan note	50,000
Loan interest paid	2,000

The loan note was issued on 1 July, 2006 with interest payable six monthly in arrears

Question 2

Trial balance extracts at 30 September, 2009

8% redeemable preference shares of $1 each	20,000
Preference dividend paid	800

The preference shares were issued on 1 April, 2009 at par. They are redeemable at a large premium which gives them an effective finance cost of 12% per annum.

Question 3

Trial balance extracts at 30 September, 2008

Loan interest paid	800
2% loan note 2010	80,000

The loan note was issued on 1 April, 2008 under terms that provide for a large premium on redemption in 2010. The finance department has calculated that the effect of this is that the loan note has an effective interest rate of 6% per annum.

Question 4

Trial balance extracts at 31 March, 2010

Preference dividend paid	2,400
6% redeemable preference shares at 31 March 2009	41,600

The 6% preference shares were issued on 1 April, 2008 at par for $40 million. They have an effective finance cost of 10% per annum due to the premium payable on redemption.

8 Taxation

For the following questions calculate the extracts where relevant from the Statement of Income and the Statement of Financial Position

Question 1

Trial balance extract at 31 March, 2007

Deferred tax liability	12,500

The provision for income tax for the year to 31 March, 2007 has been estimated at $28.3 million. The deferred tax provision at 31 March, 2007 is to be adjusted to a credit balance of $14.1 million.

Question 2

Trial balance extract at 30 September, 2008

Income tax (credit balance)	400
Deferred tax liability	11,200

The balance of income tax in the trial balance represents the under/over provision of the previous year's estimate. The estimated income tax liability for the year ended 30 September 2008 is $18.7 million. At 30 September 2008 there were $40 million of taxable temporary differences. The income tax rate is 25%. Note: you may assume that the movement in deferred tax should be taken to the income statement.

Question 3

Extract from draft financial statements at 31 March, 2009

Deferred tax liability at 1 April, 2008	19,200

During the year the company's taxable temporary differences increased by $10 million of which $6 million related to the revaluation of the property. The deferred tax relating to the remainder of the increase in the temporary differences should be taken to the income statement. The applicable income tax rate is 20%

The above figures do not include the estimated provision for income tax on the profit for the year ended 31 March 2009. The directors have estimated the provision at $11.4 million.

Question 4

Trial balance extract at 30 September, 2009

Deferred tax liability	5,800

The directors have estimated the provision for income tax for the year ended 30 September, 2009 at $11.4 million. The required deferred tax provision at 30 September, 2009 is $6 million.

Question 5

Trial balance extracts at 31 March, 2010

Current tax debit balance	700
Deferred tax liability	8,400

The directors have estimated the provision for income tax for the year ended 31 March, 2010 at $4.5 million. The required deferred tax provision at 31 March 2010 is $5.6 million; all adjustments to deferred tax should be taken to the income statement. The balance of current tax in the trial balance represents the under/over provision of the income tax liability for the year ended 31 March, 2009.

Mini Exercises – Questions

9 Sundry

Question 1

Trial balance extracts at 31 March, 2007

Purchases	78,200
Inventory at 1 April, 2006	37,800

The inventory at 31 March, 2007 was valued at $43.2 million.

Calculate the cost of sales figure.

Question 2

Trial balance extracts at 30 September, 2008

Suspense account credit balance	24,000
Equity shares of 50c each, fully paid as at 1 October, 2007	60,000

The suspense account contains the corresponding credit entry for the proceeds of a rights issue of shares made on 1 July 2008. The terms of the issue were one share for every four held at 80 cents per share. Llama's share price immediately before the issue was $1. The issue was fully subscribed.

Show the entry to remove the suspense account balance. Assuming that earnings available for equity shareholders were $26,250, calculate the earnings per share figure for the year to 30 September, 2008.

Question 3

Extracts from draft financial statements at 31 March, 2009

Retained earnings for the year to 31 March, 2009	96,700
Inventory	84,000
Receivables	52,200
Bank	3,800
Current Liabilities	81,800

Dexon's income statement includes $8 million of revenue for credit sales made on a 'sale or return' basis. At 31 March 2009, customers who had not paid for the goods, had the right to return $2.6 million of them. Dexon applied a mark up on cost of 30% on all these sales. In the past, Dexon's customers have sometimes returned goods under this type of agreement.

Show the journal entries necessary to correct the draft financial statements.

Question 4

Trial balance extracts at 30 September, 2009

Administrative expenses	22,200
Trade payables and provision	23,800

Candel is being sued by a customer for $2 million for breach of contract over a cancelled order. Candel has obtained legal opinion that there is a 20% chance that Candel will lose the case. Accordingly Candel has provided $400,000 ($2 million × 20%) included in administrative expenses in respect of the claim. The unrecoverable legal costs of defending the action are estimated at $100,000. These have not been provided for as the legal action will not go to court until next year.

Show any adjustments which you feel should be made, or explain why no adjustments are necessary.

Question 5

Trial balance extracts at 31 March, 2010

Revenue	310,000
Inventory at 31 March, 2010	28,200
Receivables	33,100
Cost of sales	234,500
Trade payables	33,400

Revenue includes $8 million for goods sold acting as an agent for Scone. On sale, a commission of 20% of sales was earned and the difference of $ 6.4 million was remitted to Scone.

Show any adjustments which you consider to be appropriate.

Question 6

Extracts from draft financial statements at 31 March, 2009

Retained earnings for the year	96,700
Retained earnings brought forward	12,300
Inventory	84,000
Trade receivables	52,200
Bank	3,800

In late March 2009 the directors of Dexon discovered a material fraud perpetrated by the company's credit controller that had been continuing for some time. Investigations revealed that a total of $4 million of the trade receivables as shown in the statement of financial position at 31 March 2009 had in fact been paid and the money had been stolen by the credit controller. An analysis revealed that $1.5 million had been stolen in the year 31 March 2008 with the rest being stolen in the current year. Dexon is not insured for this loss and it cannot be recovered from the credit controller, nor is it deductible for tax purposes.

Show any adjustments which you feel should be made.

Question 7

Trial balance extracts at 31 March, 2010

Revenue	310,000
Cost of sales	234,500

On 1 October 2009 Pricewell entered into a contract to construct a bridge over a river. The agreed price of the bridge is $50 million and construction was expected to be completed on 30 September, 2011. The $14.3 million in the trial balance is:

	$'000
material, labour and overheads	12,000
specialist plant acquired 1 October 2009	8,000
payment from customer	(5,700)
	14,300

The sales value of the work done at 31 March, 2010 has been agreed at $ 22 million and the estimated cost to complete (excluding plant depreciation) is $10 million. The specialist plant will have no residual value at the end of the contract and should be depreciated on a monthly basis. Pricewell recognises profits on uncompleted contracts on the percentage of completion basis as determined by the agreed work to date compared to the total contract price.

Calculate the revenue to be recognised, the amount to include in cost of sales, and the amounts (if any) which would be included on the S of FP.

10 Goodwill

For the following questions calculate the extracts where relevant from the Statement of Income and the Statement of Financial Position

Question 1 Petras & Signe

On 1 August, 2010, Petras acquired 3 million equity shares in Signe by an exchange of one share in Petras for every two shares in Signe plus $1 per acquired share in cash. The market price of each Petras share at the date of acquisition was $6.
Signe's retained earnings on 1 August, 2010 were $6.5m and there were 4 million shares in issue.
At the date of acquisition the fair values of Signe's assets were equal to their carrying amounts with the exception of a parcel of land which had a fair value of $500,000 below its carrying amount.
The directors have valued the nci investment as the proportional share of the Signe fair valued net assets at date of acquisition.
Goodwill is to be impaired by $900,000.

Question 2 Pyotr & Suzanna

On 1 July, 2010, Pyotr acquired 18 million shares in Suzanna. Suzanna had 24 million shares in issue as at that date. The acquisition was through a share exchange of two shares in Pyotr for every three shares in Suzanna. Both companies' shares have a nominal value of $1 each. The market price of Pyotr's shares on 1 July 2010 was $5.75 per share. Pyotr is, in addition, to pay cash on 30 June, 2012 of $2.42 for each Suzanna share acquired. (Pyotr's cost of capital is 10%).
Suzanna's retained earnings at 28 February, 2010 were $69 million and at 28 February, 2011 were $82.5 million.
At the date of acquisition Suzanna's net assets' fair value was equal to their carrying amounts with the exception of property, plant and equipment. Property fair value was $4.1 million greater than its carrying value, and plant and equipment value was $2.4 million in excess.
The directors have valued the nci investment at date of acquisition at $30 million.

Goodwill is to be impaired at 28 February, 2011 by $2 million.

Question 3 Patricija & Sergejus

On 1 November, 2009 Patricija acquired 60% of the 4 million $ equity shares of Sergejus in a share exchange of two shares is Patricija for three shares in Sergejus. At the date of acquisition shares in Patricija had a market value of $6 each.
Sergejus profit for the year ended 30 April, 2010 was $3 million and retained earnings at that date were $6.5 million. At the date of acquisition, the fair values of Sergejus' assets were equal to their carrying amounts with the exception of an item of plant which had a fair value of $2 million is excess of its carrying amount.
The non-controlling interest is to be accounted for at fair value. For this purpose, the fair value of the goodwill attributable to the non-controlling interest is $1.5 million, and goodwill is not impaired as at 30 April, 2010.

Question 4 Pious & Sebastian

On 1 December, 2008 Pious acquired 116 million shares in Sebastian for an immediate cash payment of $210 million and issued at par one 10% $100 loan note for every 200 shares acquired. Sebastian's retained earnings at the date of acquisition were $120 million, and share capital was $145 million ($1 shares) Pious' policy is to value non-controlling interests at their fair values and assessed the non-controlling interest in Sebastian at the date of acquisition to be $65 million.
The fair values of Sebastian's assets were equal to their carrying values with the exception of an item of property with a fair value of $20 million is excess of its carrying value. In addition, Sebastian owned a brand name, not recognised is its statement of financial position, with a fair value of $25 million. Goodwill in Sebastian is not impaired.

Question 5 Panda & Sloth

On 1 May, 2009 Panda purchased 80% of Sloth's 120 million $1 equity shares. The acquisition was through a share exchange of three shares in Panda for every five shares in Sloth. The market prices of shares in Panda and Sloth at 1 May, 2009 were $6 and $3.20 respectively.

	Panda	*Sloth*
Retained earnings at 1 November, 2008	40	152
Profit/ (loss) for the year ended 31 October, 2009	47.2	21
Dividend for year end 31 October, 2009	–	(8)

The fair values of Sloth's net assets at date of acquisition were equal to their carrying amounts with the exception of an item of plant which had a carrying value of $12 million and a fair value of $17 million.
In addition, Sloth owns, but has not previously recognised, a domain name with a value of $20 million Panda has credited the whole of the dividend it received from Sloth to investment income.
The non-controlling interest in Sloth is to be valued at fair value as at date of acquisition. For this purpose, the Sloth share price at that date

can be taken to be indicative of the fair value of the non-controlling interest's investment.
The goodwill in Sloth has not suffered any impairment

Question 6 Peter and Simon

On 1 April 2009 Peter acquired 75% of Simon's equity shares in a share exchange of three shares in Peter for every two shares in Simon. The market prices of Peter's and Simon's shares at the date of acquisition were $3·20 and $4·50 respectively.
In addition to this Peter agreed to pay a further amount on 1 April 2010 that was contingent upon the post-acquisition performance of Simon. At the date of acquisition Peter assessed the fair value of this contingent consideration at $4·2 million, but by 31 March 2010 it was clear that the actual amount to be paid would be only $2·7 million (ignore discounting).

Extract from the financial statements

		Peter	Simon
Equity shares of $1 each		25,000	8,000
Share premium		19,800	nil
Retained earnings	– at 1 April, 2009	16,200	16,500
	– for the year ended 31 March, 2010	11,000	1,000
		72,000	25,500

The following information is relevant:

(i) At the date of acquisition the fair values of Simon's property, plant and equipment was equal to its carrying amount with the exception of Simon's factory which had a fair value of $2 million above its carrying amount. Simon has not adjusted the carrying amount of the factory as a result of the fair value exercise. Also at the date of acquisition, Simon had an intangible asset of $500,000 for software in its statement of financial position. Peter's directors believed the software to have no recoverable value at the date of acquisition and Simon wrote it off shortly after its acquisition.

(ii) Peter's policy is to value the non-controlling interest at fair value at the date of acquisition. For this purpose Simon's share price at that date can be deemed to be representative of the fair value of the shares held by the non-controlling interest.

(iii) Impairment tests were carried out on 31 March 2010 which concluded that consolidated goodwill was impaired by $3·8 million.

Question 7 Prime and Suspect

On 1 June, 2010 Prime acquired 80% of the equity share capital of Suspect. The consideration consisted of two elements: a share exchange of three shares in Prime for every five acquired shares in Suspect and the issue of a $100 6% loan note for every 500 shares acquired in Suspect. At the date of acquisition shares in Prime had a market value of $5 each and the shares of Suspect had a stock market price of $3·50 each.

Statements of comprehensive income for the year ended 30 September 2010

	Prime	Suspect
Profit for the year	10,000	3,900
Equity shares of $1 each	12,000	5,000
Retained earnings	12,300	4,500

(i) At the date of acquisition, the fair values of Suspect's assets were equal to their carrying amounts with the exception of its property. This had a fair value of $1·2 million below its carrying amount.
(ii) Prime's policy is to value the non-controlling interest at fair value at the date of acquisition. For this purpose Suspect's share price at that date can be deemed to be representative of the fair value of the shares held by the non-controlling interest.
(iii) There has been no impairment of consolidated goodwill.

Paper F7

MINI EXERCISES – ANSWERS

1 Cost of Sales

Answer 1

Sales		300,000
Op Inv.	15,000	
Purchases	243,000	
	258,000	
Cl Inv.	(18,000)	
Cost of sales		240,000
Gross Profit		60,000
Answer	243,000	

Answer 2

Sales		450,000
Op Inv	58,333	
Purchases	400,000	
	458,333	
Cl Inv.	(75,833)	
Cost of sales		382,500
Gross profit		67,500
Answer	58,333	

Answer 3

Sales		500,000
Op Inv.	20,000	
Purchases	440,000	
	460,000	
Cl Inv.	(15,555)	
Cost of sales		444,445
Gross profit		55,555
Answer	15,555	

2 Intra-group pup

	Cost	+	*Profit*	=	*Selling Price*	
Answer 1	100		20		120	
	So 20/120 × 2/3 × 60,000			= 6,667		
	In H ↓		retained earnings		6,667	
	↓		inventory			6,667
Answer 2	75		25		100	
	So 25/120 × 3/4 × 40,000			= 7,500		
	In S ↓		retained earnings		7,500	
	↓		inventory			7,500
Answer 3	70		30		100	
	So 30/100 × 100% × 80,000			= 24,000		
	In A ↓		retained earnings		24,000	
	↓		inventory			24,000
Answer 4	100		20		120	
	So 20/120 × 66,000			= 11,000		
	In A ↓		retained earnings		11,000	
	↓		inventory			11,000
Answer 5	100		30		130	
	So 30/130 × 40% × 100,000			= 9,231		
	In A ↓		retained earnings		9,231	
	↓		inventory			9,231
Answer 6	60		40		100	
	So 40/100 × 100% × 30,000			= 12,000		
	In A ↓		retained earnings		12,000	
	↓		inventory			12,000
Answer 7	75		25		100	
	So 25/100 × 0 × 20,000			= nil		
	No adjustment necessary					
Answer 8	100		10		110	
	So 10/110 × 5,500			= 500		
	In A ↓		retained earnings		500	
	↓		inventory			500
Answer 9	100		30		130	
	So 30/130 × 0 × 90,000			= nil		
	No adjustment necessary					
Answer 10	100		40		140	
	So 40/140 × 60% × 22,000			= 3,771		
	In A ↓		retained earnings		3,771	
	↓		inventory			3,771

Mini Exercises – Answers

3 Goodwill

Answer 1

(a)

Cost of investment		900,000
Nci investment valuation		380,000
		1,280,000
NA @ doa		
Shares	800,000	
Ret ears	400,000	
		1,200,000
Goodwill		80,000

(b)

Cost of investment		900,000
Nci investment valuation		384,000
		1,284,000
NA @ doa		
as above		1,200,000
Goodwill		84,000

(c)

Cost of investment		900,000
Nci investment valuation		360,000
		1,260,000
NA @ doa		
as above		1,200,000
Goodwill		60,000

Answer 2

(a)

Cost of investment		1,300,000
Nci investment valuation		310,000
		1,610,000
NA @ doa		
Shares	1,000,000	
Ret ears	500,000	
		1,500,000
Goodwill		110,000

(b)	Cost of investment		1,300,000
	Nci investment valuation		316,000
			1,616,000
	NA @ doa		
	as above		1,500,000
	Goodwill		116,000
(c)	Cost of investment		1,300,000
	Nci investment valuation		300,000
			1,600,000
	NA @ doa		
	as above		1,500,000
	Goodwill		100,000

Answer 3

(a)	Cost of investment		350,000
	Nci investment valuation		110,000
			460,000
	NA @ doa		
	Shares	300,000	
	Ret ears	100,000	
			400,000
	Goodwill		60,000
(b)	Cost of investment		350,000
	Nci investment valuation		105,000
			455,000
	NA @ doa		
	as above		400,000
	Goodwill		55,000
(c)	Cost of investment		350,000
	Nci investment valuation (25% x 400,000)		100,000
			450,000
	NA @ doa		
	as above		400,000
	Goodwill		50,000

Mini Exercises – Answers

4 Goodwill impairments

Answer 1

(a)	Cost of investment		470,000
	Nci investment valuation		305,000
			775,000
	NA @ doa		
	Shares	500,000	
	Ret ears	200,000	
			700,000
	Goodwill		75,000
	Impairment 40%		(30,000)
			45,000
	(Nci share of impairment 40% x 30,000		12,000)
(b)	Cost of investment		470,000
	Nci investment valuation		300,000
			770,000
	NA @ doa		
	as above		700,000
	Goodwill		70,000
	Impairment 40%		28,000
			42,000
	(Nci share of impairment 40% x 28,000		11,200)
(c)	Cost of investment		470,000
	NA @ doa		
	as above	700,000	
	H's share	60%	420,000
			50,000
	Nci goodwill (given)		15,000
	Goodwill		65,000
	Impairment 40%		26,000
			39,000
	(Nci share of impairment 40% x 26,000		10,400)
(d)	Cost of investment		470,000
	Nci investment valuation (40% x 700,000)		280,000
			750,000
	NA @ doa		
	as above		700,000
	Goodwill		50,000
	Impairment		20,000
			30,000

Answer 2

(a)	Cost of investment			420,000
	Nci investment valuation			340,000
				760,000
	NA @ doa			
	Shares		300,000	
	Ret ears		400,000	
				700,000
	Goodwill			60,000
	Impairment 60%			36,000
				24,000
		(Nci share of impairment 45% x 36,000		16,200)
(b)	Cost of investment			420,000
	Nci investment valuation			324,000
				744,000
	NA @ doa			
	as above			700,000
	Goodwill			44,000
	Impairment 60%			26,400
				17,600
		(Nci share of impairment 45% x 26,400		11,880)
(c)	Cost of investment			420,000
	NA @ doa			
	as above		700,000	
	H's share		55%	385,000
				35,000
	Nci goodwill (given)			10,000
	Goodwill			45,000
	Impairment 60%			27,000
				18,000
		(Nci share of impairment 45% x 27,000		12,150)
(d)	Cost of investment			420,000
	Nci investment valuation 45% x 700,000			315,000
				735,000
	NA @ doa			
	as above			700,000
	Goodwill			35,000
	Impairment 60%			21,000
				14,000

Mini Exercises – Answers

Answer 3

(a)	Cost of investment		350,000
	Nci investment valuation		85,000
			435,000
	NA @ doa		
	Shares	250,000	
	Ret ears	100,000	
			350,000
	Goodwill		85,000
	Impairment 50%		42,500
			42,500
	(Nci share of impairment 20% x 42,500		8,500)
(b)	Cost of investment		350,000
	Nci investment valuation		80,000
			430,000
	NA @ doa		
	as above		350,000
	Goodwill		80,000
	Impairment 50%		40,000
			40,000
	(Nci share of impairment 20% x 40,000		8,000)
(c)	Cost of investment		350,000
	NA @ doa		
	as above	350,000	
	H's share	80%	280,000
			70,000
	Nci goodwill (given)		13,000
	Goodwill		83,000
	Impairment 50%		41,500
			41,500
	(Nci share of impairment 20% x 41,500		8,300)
(d)	Cost of investment		350,000
	Nci investment valuation 20% x 350,000		70,000
			420,000
	NA @ doa		
	as above		350,000
	Goodwill		70,000
	Impairment 50%		35,000
			35,000

5 Excess depreciation & pup

Answer 1

H

?

↓ 40,000π

? ⌒ ?

40,000 is pup

So in H	↓	retained earnings	40,000	
	↓	TNCA		40,000

Answer 2

S	100,000		
4 yrs dep	(40,000)	5,000π	
	60,000	⌒	65,000
	8,000		9,000
	52,000	1,000 xs dep	56,000

So, in S	↓	retained earnings	5,000	
	↓	TNCA		5,000
in H	↑	retained earnings	1,000	
	↑	TNCA		1,000

6 Non current assets

Answer 1

	Land	Buildings
On purchase	70,000	200,000
depreciation to last year (15 yrs)	–	60,000
	70,000	140,000
revaluation	10,000	35,000
	80,000	175,000

So	DR	Land	10,000	
	DR	Accumulated depreciation	35,000	
	CR	Revaluation reserve		45,000
and				
	DR	Depreciation expense (cos)	5,000	
	CR	Accumulated depreciation		5,000
and				
	DR	Revaluation reserve		1,000
	CR	S of Comp Inc		1,000

Inventory property of Kala

Plant depreciation 15% × (156,000-26,000)

15% × 130,000

	DR	Depreciation expense (cos)	19,500	
	CR	Accumulated depreciation		19,500

Plant as finance lease

	DR	TNCA leased plant	92,000	
	CR	OUFL a/c		92,000
	DR	Depreciation expense (cos)	18,400	
	CR	Accumulated depreciation		18,400

Mini Exercises – Answers

DR	OUFL a/c		22,000	
CR	Rental of leased plant			22,000
(to correct incorrect accounting treatment)				
DR	Finance costs (finance lease interest)			
	10% × 70,000		7,000	
CR	OUFL a/c			7,000

Answer 2

	Land	Buildings
at valuation	30,000	100,000
depreciation for yr to 2008	–	5,000
	30,000	95,000
revaluation deficit	–	3,000
	30,000	92,000

So	DR	Revaluation reserve	3,000	
	CR	Buildings		3,000
and				
	DR	Depreciation expense	5,000	
	CR	Accumulated depreciation		5,000
split				
60% (3,000) to cost of sales				
20% (1,000) to distribution costs				
20% (1,000) to administrative expense				
own made plant – costs			24,000	
So				
	DR	Depreciation expense 12½ × ⅝ × 24,000	1,500	
	CR	Accumulated depreciation		1,500
and				
	DR	TNCA 24,000		
	CR	Cost of sales		24,000

Answer 3

	DR	Depreciation expense, buildings	11,000	
	CR	Accumulated depreciation		11,000
	DR	Buildings accumulated depreciation	6,000	
	CR	Revaluation reserve		6,000
	DR	Depreciation expense, plant	36,100	
	CR	Accumulated depreciation		36,100
	DR	Investments at fair value through profit and loss	1,000	
	CR	S of CI		1,000

Answer 4

	DR	Depreciation expense (cos), leasehold property	2,500	
	CR	Accumulated depreciation		2,500
	DR	Revaluation reserve	4,500	
	CR	Leasehold property		4,500
	DR	Sales revenue	2,500	
	CR	Plant		8,000
	DR	Plant Accumulated depreciation	4,000	
	DR	Disposal account	8,000	
	CR	Disposal account		4,000
	CR	Disposal account		2,500

DR	S of CI	1,500	
	CR Disposal account		1,500
DR	Depreciation expense (cos)	9,600	
	CR Accumulated depreciation (plant)		9,600

Development expenditure

1.10.08 – 31.12.08	1,400
1.1.09 – 31.3.09	2,400
1.4.09 – 30.9.09	4,800

So, 3,800 correctly expensed in cost of sales
4,800 should be capitalised

and	amortise 20 million @ 20%	4,000
and	4,800 @ 20% for 6 months	480

DR	R + D Amortisation	4,480	
	CR Accumulation amortisation		4,480

Answer 5

DR	S of CI Impairment of property	300	
	CR leasehold property		300
DR	Depreciation expense (cos)	8,500	
	CR Accumulated depreciation (plant)		8,500
DR	Depreciation expense (cos)	5,000	
	CR Accumulated depreciation (leased plant)		5,000

7 Loan interest / preference dividends

Answer 1

8% × 50,000 = 4,000 loan interest for a full year
But it's only for 9 months, so S of C1 should be charged with 9/12 × 4,000 = 3,000
Only 2,000 is in the trial balance
∴ need to accrue 1,000 (ie 3,000 – 2,000)

DR	Finance costs	1,000	
	CR Current liabilities		1,000

Answer 2

8% × 20,000 = 1,600 pref div for a full year
But, effective rate is 12%
So full charge should be 12% × 20,000 = 2,400 for a full year
But these are only in issue for 6 months
Therefore correct charge in S of CI is 6/12 × 12% × 20,000 ie, 1,200
In trial balance, 800 has been paid
Therefore need to accrue a further 400

DR	Finance Costs	400	
	CR Long term liability		400

Answer 3

6% × 80,000 = 4,800 loan interest for a full year
But this is only a 6 month loan
So correct S of CI charge is 6/12 × 6% × 80,000 ie, 2,400
In trial balance, 800 has been paid
Therefore need to accrue a further 1,600

DR	Finance costs	1,600	
	CR 2% loan note 2010		1,600

Answer 4

10% × 40,000 = 4,000
Trial balance includes only 2,400
Therefore need to accrue the difference 1,600 (4,000-2,400)

DR	Finance costs		1,600	
CR	6% redeemable pref shares			1,600

8 Taxation

Answer 1

DR	S of CI taxation (current)		28.3	
DR	S of CI taxation (deferred) (14.1-12.5)		1.6	
CR	Current liabilities			28.3
CR	Deferred liabilities			1.6

Answer 2

DR	S of CI taxation (current)		17.1	
CR	S of CI taxation (current)			1.2
CR	Current liabilities			17.1
DR	Deferred liabilities		1.2	

Answer 3

DR	S of CI taxation (current)		11.4	
CR	Current liabilities			11.4
DR	S of CI taxation (current)		.8	
CR	Deferred liabilities			2.0
DR	Revaluation reserve		1.2	

Answer 4

DR	S of CI taxation (current)		11.4	
DR	S of CI taxation (deferred)		.2	
CR	Current liabilities			11.4
CR	Deferred liabilities			.2

Answer 5

DR	Deferred liability		2.8	
CR	Current liability			2.8
DR	S of CI		2.4	
CR	Current liability			2.4

9 Sundry

Answer 1

Opening inventory		37,800
Purchases		78,200
		116,000
Less closing inventory		43,200
Cost of sales (answer)		72,800

Answer 2

DR	Suspense account		24,000	
CR	Share capital			15,000
CR	Share premium			9,000

Answer 20c per share

Answer 3

DR	Revenue		2,600	
CR	Receivables			2,600
DR	Inventory (S of FP)		2,000	
CR	Cost of Sales			2,000

Answer 4

20% Chance of losing ∴ 80% chance of winning
∴ No provision required, just a disclosure note

So,	DR	Provisions	400	
		CR Administrative expenses		400
but,	DR	Administrative expenses	100	
		CR Provisions		100

Answer 5

	DR	Revenue	8,000	
		CR Cost of Sales		6,400
		CR Commissions receivable		1,600

Answer 6

	DR	Retained earnings b/f	1,500	
	DR	Retained earnings this year S of CI	2,500	
		CR Receivables		4,000

Answer 7

Revenue recognised 22/50 × 50m	22,000	Answer 1
Costs recognised 22/50 × (12 +8 +10)	13,200	Answer 2
∴ Profit recognised	8,800	
Costs to date 12 + (6/24 × 8)	14,000	
+ Attributable profit	8,800	
	22,800	
- Amount received	5,700	
Amounts due from customers	17,100	Answer 3

10 Goodwill

Answer 1 Petras & Signe

Cost of investment

Shares issued 3,000,000/2 × 1 × $6		9,000,000
Cash 3,000,000 × $1		3,000,000
Nci investment		12,000,000
NA @ doa		2,500,000
		14,500,000
Shares	4,000,000	
Ret ears	6,500,000	
fv adjustment, land	(500,000)	
		10,000,000
Goodwill		4,500,000
Impairment		900,000
		3,600,000

Mini Exercises – Answers

Answer 2 Pyotr & Suzanna

Cost of investment

Shares 18,000,000/3 ×2 × $5.75		69,000,000
Cash 18,000,000 × 2.42/1.1/1.1		36,000,000
Nci investment		30,000,000
		135,000,000
NA@ doa		
Shares	24,000,000	
Ret ears b/fwd	69,000,000	
Ret ears 4 months	4,500,000	
fv adjustment, property	4,100,000	
Plant	2,400,000	
		104,000,000
		31,000,000
Impairment		2,000,000
		29,000,000

Answer 3 Patricija & Sergejus

Cost of investment

Shares 60% × 4/3 × 2× $6		9,600,000
NA @ doa		
Shares	4,000,000	
Ret ears b/f	3,500,000	
Ret ears 6 months	1,500,000	
fv adjustment, plant	2,000,000	
	11,000,000	
P's share	60%	6,600,000
		3,000,000
Nci goodwill, per question		1,500,000
Goodwill		4,500,000

Answer 4 Pious & Sebastian

Cost of investment

Cash		210,000
Loan note 116/200 x $100		58,000
Nci investment valuation		65,000
		333,000
NA@ doa		
Shares	145,000	
Ret ears	120,000	
fv adjustments, property	20,000	
brand	25,000	
		310,000
Goodwill		23,000

Answer 5 Panda & Sloth

Cost of investment		
80% × 120/5 × 3 × $6		345,600,000
Nci investment valuation		76,800,000
		422,400,000
NA@ doa		
Shares	120,000,000	
Ret ears brought forward	152,000,000	
Ret ears 6 months	10,500,000	
fv adjustments, plant	5,000,000	
domain name	20,000,000	
		307,500,000
Goodwill		114,900,000

Answer 6 Peter & Simon

Cost of investment		
Shares 75% × 8m /2×3× $3.20		28,800,000
Cash, contingent consideration		4,200,000
Nci investment valuation 25% × 8m × $4.50		9,000,000
		42,000,000
NA@ doa		
Shares	8,000,000	
Ret ears brought forward	16,500,000	
fv adjustment, factory	2,000,000	
software	(500,000)	
	26,000,000	
Goodwill		16,000,000
Impairment		3,800,000
		12,200,000

Answer 7 Prime & Suspect

Cost of investment		
Shares 80% × 5000 / 5 × 3 × $5		12,000,000
Loan note 80% × 5000 / 500 × 100		800,000
Nci investment valuation 20% × 5,000 × $3.50		3,500,000
		16,300,000
NA @ doa		
Shares	5,000,000	
Ret ears brought forward	600,000	
Ret ears 8 months	2,600,000	
fv adjustments, property	(1,200,000)	
	7,000,000	
Goodwill		9,300,000

PRACTICE QUESTIONS

1 Mobile

Mobile, a pharmaceutical manufacturing entity, has an authorised share capital of 800,000 equity shares of 50c each.
Balances extracted from Mobile accounting records as at 31 March, 20X9 showed the following position:

		$
Rent expenses		16,810
Heat and light		15,410
Carriage outwards		4,810
Bad debts		14,000
Insurance premiums	- buildings	9,000
	- contents	5,160
Repairs to plant and equipment		12,000
Stationery		14,000
Postage		9,980
Manufacturing wages		158,410
Office salaries		36,980
Directors salaries	- sales	41,000
	- production	39,000
	- other	51,440
Bank interest paid		12,000
Dividends paid		16,000
Non-current assets at cost	- freehold property	1,440,000
	- plant and equipment	810,000
	- furniture and fittings	264,000
Loan interest paid		14,000
Purchases		2,454,000
Rents received		28,000
Sales		3,320,000
Share capital		400,000
Inventory as at 1 April, 20X8		112,000

You also obtain the following information:

(1) freehold property, plant and equipment, and furniture and fittings are written off over periods of 40 years, 4 years and 8 years respectively. None of the assets has been fully depreciated. Depreciation has not been provided for the current year.

(2) inventory as at 31 March 20X9 has been valued at $176,000.

(3) income tax of $36,000 is to be provided for the year.

(4) the directors proposed a total dividend for the year of 5c per equity share on 20 March 20X9.

Prepare the Statement of Comprehensive Income of Mobile for the year ended 31 March 20X9, in a form suitable for presentation to shareholders including the profit from operations note.

Note: You should think carefully about the classification of expenses.

2 Numbers

The following list of account balances has been prepared by Numbers, plastics manufacturers, on 31 May, 20X8, which is the end of the entity's accounting period:

	$	$
Share capital		
300,000 equity shares		
of $1 each, fully paid		300,000
100,000 8.4% cumulative preference shares of		
$1 each, fully paid		100,000
Revaluation surplus		50,000
Share premium account		100,000
General reserve		50,000
Retained earnings - 1 June 20X7		283,500
Patents and trademarks	215,500	
Freehold land at cost	250,000	
Leasehold property at cost	75,000	
Amortisation of leasehold property - 1 June 20X7		15,000
Factory plant and equipment at cost	150,000	
Accumulated depreciation - plant and equipment - 1 June 20X7		68,500
Fixtures and fittings at cost	50,000	
Accumulated depreciation - fixtures and fittings - 1 June 20X7		15,750
Motor vehicles at cost	75,000	
Accumulated depreciation - motor vehicles - 1 June 20X7		25,000
10% debentures (2001 - 2015)		100,000
Receivables/payables	177,630	97,500
Bank overdraft		51,250
Inventory - raw materials at cost - 1 June 20X7	108,400	
Purchases - raw materials	750,600	
Carriage inwards - raw materials	10,500	
Manufacturing wages	250,000	
Manufacturing overheads	125,000	
Cash	5,120	
Work in progress - 1 June 20X7	32,750	
Sales		1,526,750
Administrative expenses	158,100	
Selling and distribution expenses	116,800	
Financial, legal and professional expenses	54,100	
Provisions for doubtful debts - 1 June 20X7		5,750
Inventory - finished goods - 1 June 20X7	184,500	
	2,789,000	2,789,000

Practice Questions

Additional information:

(1) Inventories at 31 May 20X8 were:

	$
Raw materials	112,600
Finished goods	275,350
Work in progress	37,800

(2) Depreciation for the year is to be charged as follows:

Plant and equipment	8% on cost	- charged to production expenses
Fixtures and fittings	10% on cost	- charged to administrative expenses
Motor vehicles	20% on reducing value	- 25% charged to administrative expenses
		- 75% selling and distribution expenses

(3) Manufacturing overheads include:

Plant hire	10,000
Works director's salary	10,000

(4) Administrative expenses include:

Executive directors' salaries (three at $8,000 and one at $11,000)	35,000
Non-executive chairman's fees	2,500

(5) Selling expenses include:

Sales director's salary	12,500

(6) Financial, legal and professional expenses include:

Auditors' fees	10,000
Auditors' expenses	500
Taxation service fees (provided by the auditors)	1,250
Solicitors' fees for purchase of freehold property during year	5,000

(7) Provision is to be made for a full year's interest on the debentures.

(8) Income tax at 33% on the profits of the year is estimated at $40,000 and is due for payment on 28 February 20X9.

(9) The directors have proposed that a dividend of 3.5c per share be paid on the equity share capital. No dividend was paid for the year ended 31 May 20X7.

(10) The leasehold land and buildings are held on a 50 year lease, acquired ten years ago.

From the information given above, prepare the Financial Statements of Numbers for the year ended 31 May 20X8 for publication in accordance with International Financial Reporting Standards. Ignore the requirement for comparatives, a directors' report and Statement of Cash Flows, but include a Statement of Changes in Equity.

3 Gill and Job

Gill acquired 90% of the share capital of Job upon its incorporation on 1 January 20X1 for $25,000.

Their respective Statements of Financial Position as at 31 December 20X5 are as follows:

	Gill	*Job*
Non-current assets:	*$*	*$*
Property, plant & equipment	135,000	60,000
Investment in Job	25,000	
	160,000	60,000
Current assets	62,000	46,000
Total assets	222,000	106,000
Capital and reserves		
Share capital ($1 equity shares)	50,000	25,000
Revaluation surplus	50,000	15,000
Retained earnings	90,000	40,000
	190,000	80,000
Non-current liabilities	14,000	12,000
Current liabilities	18,000	14,000
Total equity and liabilities	222,000	106,000

Goodwill had been impaired by 80% as at 31 December, 2009 and is now to be fully impaired.

The NCI investment at date of acquisition was valued at $3,000

Produce the Consolidated Statement of Financial Position of Gill and its subsidiary as at 31 December 20X5.

4 August Group

August purchased 75% of Scone for $2,000,000 10 years ago when the balance on its retained earnings was $1,044,000. The Statements of Financial Position of the two entities as at 31 March 20X4 are as follows:

	August		*Scone*	
	$'000	*$'000*	*$'000*	*$"000*
Non-current assets				
Investment in Scone		2,000		
Land and buildings		3,350		-
Plant and equipment		1,010		2,210
Motor vehicles		510		345
		6,870		2,555
Current assets				
Inventory	890		352	
Receivables	1,372		514	
Cash at bank and in hand	89		51	
		2,351		917
Total assets		9,221		3,472
Share capital				
($1 equity shares)	1,000		500	
Revaluation surplus	2,500		-	
Retained earnings	4,225		2,610	
		7,725		3,110
Non-current liabilities				
10% debentures		500		-
Current liabilities				
Trade payables		996		362
Total equity and liabilities		9,221		3,472

The following additional information is available:

(1) Included in receivables of August are amounts owed by Scone of $75,000. The current accounts do not at present balance due to a payment for $39,000 being in transit at the year end from Scone.

(2) Included in the inventory of Scone are items purchased from August during the year for $31,200. August marks up its goods by 30% to achieve its selling price.

(3) Goodwill has been impaired by 50%

(4) The value of the NCI investment at date of acquisition was $3.50 per share.

Prepare the Consolidated Statement of Financial Position for the August Group of entities as at 31 March 20X4.

5 Wear

Wear has held shares in two entities, Seat and Bow, for a number of years. As at 31 December 20X4 they have the following Statements of Financial Position:

	Wear		*Seat*		*Bow*	
	$'000	*$'000*	*$'000*	*$'000*	*$'000*	*$'000*
Non-current assets:						
Property, plant & equipment	370		190		260	
Investments	218		–		-	
		588		190		260
Current assets:						
Inventories	160		100		180	
Receivables	170		90		100	
Cash	50		40		10	
		380		230		290
Total assets		968		420		550
Equity						
Share capital ($1 ords)		200		80		50
Share premium		100		80		30
Retained earnings		568		200		400
		868		360		480
Current liabilities						
Trade payables		100		60		70
Total equity and liabilities		968		420		550

You ascertain the following additional information:

(1) The 'investments' in the Statement of Financial Position comprise solely Wear's investment in Seat ($128,000) and in Bow ($90,000).

(2) The 48,000 shares in Seat were acquired when Seat's retained earnings were $20,000.

The 15,000 shares in Bow were acquired when that entity had a retained earnings balance of $150,000.

(3) When Wear acquired its shares in Seat the fair value of Seat's net assets equalled their book values with the following exceptions:

	$'000
Non-current assets	50 higher
Inventory	20 lower (all now sold)

Depreciation arising on the fair value adjustment to non-current assets since this date is $5,000.

(4) During the year, Wear sold inventory to Seat for $16,000, which originally cost Wear $10,000. Three-quarters of this inventory has subsequently been sold by Seat.

(5) All three entities proposed a dividend of $20,000 before the year end which have not yet been accounted for.

(6) Goodwill had been fully impaired by 1 January 20X4.

(7) It is the group policy to value the non-controlling interest's investment as their proportionate share of the subsidiary's fair valued net assets as at date of acquisition.

Produce the Consolidated Statement of Financial Position for the Wear Group incorporating the associate.

6 Orange and Nancy

Orange acquired a 60% holding in Nancy three years ago when Nancy's retained earnings balance stood at $16,000. Both businesses have been very successful since the acquisition and their respective Statements of Comprehensive Income for the year ended 30 June 20X8 are as follows:

	Orange	*Nancy*
	$	*$*
Revenue	403,400	193,000
Cost of sales	201,400	92,600
Gross profit	202,000	100,400
Distribution costs	16,000	14,600
Administrative expenses	24,250	17,800
Profit from operations	161,750	68,000
Dividends from Nancy	9,000	
Profit before tax	170,750	
Income tax expense	61,750	22,000
Profit after tax/net profit for the year	109,000	46,000

During the year Nancy sold some goods to Orange for $40,000, including 25% mark up. Half of these items were still in inventory at the year-end.

Statement of Changes in Equity (extract)

	Orange	**Nancy**
	Retained earnings	**Retained earnings**
	$	*$*
Balance at 30 June 20X7	163,000	61,000
Net profit for the year	109,000	46,000
Dividends	(40,000)	(25,000)
Balance at 30 June 20X8	232,000	82,000

Produce the Consolidated Statement of Comprehensive Income of Orange and its subsidiary for the year ended 30 June 20X8, and an extract from the Statement of Changes in Equity, showing retained earnings. Goodwill is to be ignored.

7 Dole

Dole is an entity whose activities are in the field of major construction projects. During the year ended 30 September 20X7, it enters into three separate construction contracts, each with a fixed contract price of $1,000,000. The following information relates to these contracts at 30 September 20X7:

	A	*B*	*C*
Contract	*$'000*	*$'000*	*$'000*
Payments on account (including amounts receivable)	540	475	400
Costs incurred to date	500	550	320
Estimate costs to complete the work	300	550	580
Estimate percentage of work completed	60%	50%	35%

(a) Show how each contract would be reflected in the Statement of Financial Position of Dole at 30 September 20X7 under IAS 11 (revised).

(b) Show how each contract would be reflected in the Statement of Comprehensive Income of Dole for the year ended 30 September 20X7 under IAS 11 (revised).

8 Nice

Using the information below prepare the Statement of Comprehensive Income and Statement of Changes in Equity for Nice for the year ended 31 December 20X9.

(a) Nice Statement of Comprehensive Income extract

	$'000
Profit from operations	792
Finance income	24
Finance cost	(10)
Profit before tax	806
Income tax	(240)
Profit after tax	566
Dividend	(200)
Retained profit	366

(b) Non-current assets

(i) Assets held at cost were impaired by $25,000.

(ii) Freehold land and buildings were revalued to $500,000 (Book value $380,000).

(iii) A previously revalued asset was sold for $60,000. Details of the revaluation are as follows:

	$
Book value at revaluation	30,000
Revaluation	50,000
	80,000
Depreciation (80,000/10) × 3)	24,000
	56,000

Nice has been following paragraph 39 of IAS 16 which allows a reserve transfer to retained earnings of the realised revaluation surplus (the difference between depreciation based on revalued amount and depreciation based on cost) as the asset is used.

(iv) Details of investment properties are as follows:

	$
Original cost	120,000
Revaluation surplus	40,000
Value at 1.1.20X9	160,000

The properties had a valuation on 31 December 20X9 of $110,000. Nice previously accounted for its investment properties by crediting gains to a revaluation surplus as allowed in the past by IAS 25. Nice now wishes to apply the fair value model of IAS 40 which states that gains and losses should be accounted for in the Statement of Comprehensive Income and that any previous revaluation surplus should be treated as a change in accounting policy. No adjustment has yet been made for the change in accounting policy or subsequent fall in value.

(c) Share capital

During the year the entity had the following changes to its capital structure.

(i) A bonus issue of $200,000 $1 equity bonus shares capitalising its share premium account

(ii) An issue of 400,000 $1 equity shares (issue price $1.40 per share).

(d) Shareholder's equity

The book value of shareholders' equity at the start of the year was as follows:

	$
Issued capital	2,800,000
Share premium	1,150,000
Revaluation surplus	750,000
Retained earnings	2,120,000
	6,820,000

9 Tours

Tours entered into a lease for compressor equipment costing $12,000. The lease was signed on 1 January 20X1 and provided for 8 annual rentals of $2,004 payable in advance followed by a secondary term of 17 years at a nominal rental of $1 pa renewable at the option of the lessee.

On the same day, Bite entered into a lease with identical terms except that all rentals were payable in arrears - ie on 31 December each year rather than 1 January.

For both entities, the estimated useful life of the equipment is 15 years and both entities have financial years ending on 31 December. The interest rate implicit in the Speedpair lease is 9.26% and that for Bite is 6.928%

Produce extracts from the Financial Statements for the year ending 31 December 20X2 to show how the above transactions would be reflected by Tours and Bite respectively.

10 Dial

The following information relates to Dial:

(1) The net book value of plant and equipment at 30 September 20X6 is $1,185,000.

(2) The tax written down value of plant and equipment at 1 October 20X5 was $405,000.

(3) During the year ended 30 September 20X6, the entity bought plant and equipment of $290,000, which is eligible for tax depreciation.

(4) Dial bought its freehold property in 20W5 for $600,000. It was revalued in the 20X5 accounts to $1,500,000. Ignore depreciation on buildings. No tax allowances were available to Dial on the buildings.

Draft the Statement of Financial Position note at 30 September 20X6 omitting comparatives, in respect of deferred tax.

Work to the nearest $'000. Assume a current income tax rate of 30%. Tax depreciation is at 25% on a reducing balance basis. Timing differences are expected to reverse in 20X7. The income tax rate enacted for 20X7 is 28%.

11 Code

The following is a list of account balances from the books of Code on 31 October 20X1 and 31 October 20X2, and an extract from the Statement of Comprehensive Income for the year ended 31 October 20X2.

	20X1	*20X2*
	$'000	*$'000*
Ordinary share capital	1,800	2,000
7.5% preference shares	400	200
Share premium	40	140
Retained earnings	213	438
Land at cost	500	570
Buildings at net book value	1,400	1,200
Plant and equipment at net book value	740	830
Vehicles at net book value	420	485
Inventories	202	246
Receivables	248	294
Cash at bank	20	-
Payables	167	106
Income tax liability	100	140
Bank overdraft	-	36
Long-term loan	600	350
Proposed dividends: - ordinary	180	200
- preference	30	15

Extracts from Statement of Comprehensive Income of Code for the year ended 31 October 20X2

Profit from operations	643
Finance cost (interest)	63
Profit before tax	580
Income tax expense	140
Profit after tax	440

Code has proposed dividends of $215

Additional information

1. At 1 November 20X1 the balances on the accumulated depreciation accounts were as follows:

	$'000
Buildings	350
Plant and equipment	465
Vehicles	310

2. The information below relates to assets sold during the year ended 31 October 20X2.

	Cost	*Accumulated depreciation*	*Profit/(loss) on sales*
	$'000	*$'000*	*$'000*
Buildings	250	155	20
Plant and equipment	220	105	(30)
Vehicles	120	70	(10)

3. Depreciation charged for the year ended 31 October 20X2 was as follows:

	$'000
Buildings	105
Plant and equipment	205
Vehicles	65

4. On 30 April 20X2 a rights issue of 200,000 ordinary $1 shares at $1.50 per share was fully subscribed.

Note: Advanced tax is to be ignored.

Prepare for Code a Statement of Cash Flows for the year ended 31 October 20X2 in the form required by IAS 7 (revised). Use the indirect method.

12 Jauciu

The summarised Statement of Comprehensive Income for Jauciu for the year ended 31 August, 2009 is set out below:

	$'000
Profit before tax	600
Tax	(180)
Profit after tax	420

Jauciu had $500,000 equity shares in issue with a nominal value of 50c each on 1 September, 2008. On 31 January, 2009, Jauciu issued further shares with a nominal value of $200,000 at full market price.

On 1 April, 2009 Jauciu made a bonus issue of 3 shares for every 7 held, and on 31 May, 2009 made a rights issue of 3 shares for every 10 at an exercise price of $2.50.
Mid market price throughout the year was $4.00 per share.
Corporate tax rate is 28%.
Last year's disclosed earnings per share figure was 25c.

Throughout the year Jauciu had borrowed $70,000 by way of convertible loan carrying interest at 7%. The terms of conversion allowed the holders to exchange the loan into equity shares on the basis of either:
- for every $100 loan, 190 equity shares on 1 January, 2011
- for every $90 loan, 185 equity shares on 1 January, 2012
- for every $120 loan, 240 equity shares on 1 January 2015

In addition, the directors held share options allowing them to buy 2,000,000 equity shares at a price of $3,00 on or after 30 April 2013.

Calculate the basic earnings per share and the diluted earnings per share for Jauciu for the year ended 31 August, 2009

PRACTICE ANSWERS

1 Mobile

Statement of Comprehensive Income for the year ended 31 March 20X9

	Note	*$'000*
Revenue		3,320,000
Cost of sales (W1)		(2,817,320)
Gross profit		502,680
Other operating income		28,000
Distribution costs (W2)		(45,810)
Administrative costs (W3)		(126,400)
Other operating expenses (W4)		(99,970)
Profit from operations	1	258,500
Finance cost (W5)		(26,000)
Profit before tax		232,500
Income tax expense		(36,000)
Profit after tax		196,500

Statement of Changes in Equity (extract)

Retained earnings brought forward		x
Profit for the year		196,500
Non-controlling interest		-
Dividends (W6)		(40,000)
Retained earnings carried forward		156,500 + x

Note:

Profit from operations is stated after charging:	
Depreciation	271,500
Employee costs	326,830

Workings

W1 Cost of sales

	$	*$*
Opening inventory		112,000
Purchases		2,454,000
		2,566,000
Depreciation plant and equipment (25% × 810,000)	202,500	
Heat and light	15,410	
Repairs to plant and equipment	12,000	
Manufacturing wages	158,410	
Production director	39,000	
		427,320
Closing inventory		(176,000)
Cost of sales		2,817,320

W2 Distribution costs

	$
Carriage outwards	4,810
Sales director	41,000
	45,810

W3 Administrative expenses

	$
Bad debts	14,000
Office salaries	36,980
Other directors	51,440
Postage	9,980
Stationery	14,000
	126,400

W4 Other operating expenses

		$
Rent		16,810
Insurance premiums - buildings		9,000
	- contents	5,160
Depreciation	- freehold (1,440 × 1/40)	36,000
	- furniture and fittings (264 × 1/8)	33,000
		99,970

Alternatives

(a) bad debt expenses could have been treated as distribution.

(b) building insurance could have been treated as COS if you assume the building is the factory not the warehouse. The same applies to the depreciation.

W5 Finance cost

	$
Bank interest	12,000
Loan interest	14,000
	26,000

W6 Dividends

Total dividend (5c × 800,000) = $40,000

2 Numbers

Statement of Comprehensive Income for the year ended 31 May 20X8

	$	$
Revenue		1,526,750
Cost of sales (W3)		1,048,000
Gross profit		478,750
Distribution costs (W4)	124,300	
Administrative expenses (W5)	216,200	340,500
Profit from operations		138,250
Finance cost (Note 2)		18,400
Profit before tax		119,850
Income tax expense		40,000
Profit after tax/net profit for the year		79,850

Statement of Financial Position as at 31 May 20X8

	$	$
ASSETS		
Non-current assets		
Patents and trade marks	215,500	
Land and buildings (Note 4)	313,500	
Plant and equipment (Note 4)	69,500	
Motor vehicles (Note 4)	40,000	
Fixtures and fittings (Note 4)	29,250	
		667,750
Current assets		
Inventories (Note 5)	425,750	
Receivables (Note 6)	171,880	
Cash in hand	5,120	
		602,750
TOTAL ASSETS		1,270,500
Equity		
Issued share capital (Note 7)	300,000	
Share premium account	100,000	
Revaluation surplus	50,000	
General reserve	50,000	
Retained earnings	352,850	
		852,850
Non-current liabilities		
10% debentures		100,000
8.4% preference shares		100,000
Current liabilities		
Bank overdraft	51,250	
Trade payables	97,500	
Loan interest	18,400	
Dividends	10,500	
Income tax	40,000	
		217,650
TOTAL EQUITY AND LIABILITIES		1,270,500

Statement of Changes in Equity for the year ended 31 May 20X8 (extract)

	Retained earnings
Balance at 1 June, 20X7	283,500
Net profit for the year	79,850
Dividends	(10,500)
Balance at 31 May, 20X8	352,850

Financial Statements for year ended 31 May 20X8

Notes to the financial statements

(1) Statement of Accounting Policies

(a) These financial statements have been prepared under the historical cost convention

(b) Depreciation of non-current assets is provided on the following bases

(i)	Leasehold land and buildings	2%	on cost
(ii)	Plant and equipment	8%	on cost
(iii)	Fixtures and fittings	10%	on cost
(iv)	Motor vehicles	20%	on reducing value

(c) Inventories are valued at the lower of cost and net realisable value.

(2) Finance Costs

Interest expense on debenture loans		10,000
Preference dividend	(8.4%)	8,400
		18,400

(3) Dividends

Ordinary dividend - proposed	(3.5c)	10,500

(4) Tangible non-current assets

	Freehold land & buildings	*Leasehold land & buildings*	*Factory plant & equipment*	*Motor vehicles*	*Fixtures and fittings*	*Total*
	$	*$*	*$*	*$*	*$*	*$*
Cost or valuation at 1.6.X7	–	75,000	150,000	75,000	50,000	350,000
Additions	255,000	–	–	–	–	255,000
Cost or valuation at 31.5.X8	255,000	75,000	150,000	75,000	50,000	605,000
Depreciation at 1.6.X7	–	15,000	68,500	25,000	15,750	124,250
Charge for the year	–	1,500	12,000	10,000	5,000	28,500
Depreciation at 31.5.X8	–	16,500	80,500	35,000	20,750	152,750
NBV at 31.5.X8	255,000	58,500	69,500	40,000	29,250	452,250
NBV at 1.6.X7	–	60,000	81,500	50,000	34,250	225,750

(5) Inventories

Raw materials	112,600
Work in progress	37,800
Finished goods	275,350
	425,750

(6) Receivables

	$
Trade receivables (177,630 - 5,750)	171,880

(7) Called-up Share Capital

	Issued $
Share capital:	
300,000 equity shares of $1 each, fully paid	300,000

Workings

W1 Depreciation

Cost of sales:	8% × 150,000	12,000
Administration:	10% × 500,000	5,000
	¼ × 20% × 50,000	2,500
		7,500
Selling and distribution:		
	¾ × 20% × 50,000	7,500

W2 Depreciation (amortisation) of lease:

1/50 × $75,000	1,500

W3 Calculation of cost of sales

Raw materials consumed:		
Opening inventory	108,400	
Purchases	750,600	
	859,000	

Closing inventory	112,600	
		746,400
Carriage inwards		10,500
Manufacturing wages		250,000
Prime cost		1,006,900
Manufacturing overheads	125,000	
Depreciation of plant	12,000	
		137,000
		1,143,900
Adjustment for increase in work in progress		
(opening 32,750 – closing 37,800)		(5,050)
Cost of manufactured goods		1,138,850
Opening inventory of finished goods		184,500
		1,323,350
Closing inventory of finished goods		(275.350)
Cost of goods sold		1,048,000

W4 Distribution costs

	$
per question	116,800
depreciation (W1)	7,500
	124,300

W5 Administrative expenses per question 158,100

financial expenses	54,100	
less: solicitors' fees capitalised	5,000	
		49,100
Depreciation (W1)		7,500
Amortisation of lease (W2)		1,500
		216,200

3 Gill and Job

Consolidated Statement of Financial Position as at 31 December 20x5

	$
TNCA (135 + 60)	195,000
CA (62 + 46)	108,000
Total assets	303,000
Shares	50,000
Ret earnings (W3)	123,300
Revaluation surplus (50 + 90% × 15)	63,500
Non-controlling interest (W4)	8,200
	245,000
NC liabilities (14 + 12)	26,000
CL (18 +14)	32,000
Total equity and liabilities	303,000

Workings

W1 Group structure

G
|
90%
J ——— 10%

W2 Goodwill

		$	$
Cost of investment			25,000
Nci investment valuation			3,000
			28,000
Net assets at date of acquisition:			
Shares		25,000	
			25,000
Goodwill			3,000
Impaired 80 % brought forward			2,400
Impaired this year			600
(Nci share of impairment brought forward	10% x 2,400	240	
Nci share of this year's impairment	10% x 600	60)	

W3 Consolidated retained earnings

	G	J
per question	90,000	40,000
– pre acquisition		–
∴ post acquisition		40,000
Our share (90%)	36,000	90%
	126,000	
Less goodwill impairment	2,700	
	123,300	

W4 Non-controlling interest (10%)

Value @ doa	3,000
Share of J's post acq ret'd 10% x 40,000	4,000
	7,000
Less goodwill impairment	300
	6,700
+ 10% x revaluation reserve	1,500
	8,200

4 August Group

Consolidated Statement of Financial Position as at 31 March 20X4

	$
INCA (W2)	446,750
TNCA L + B	3,350,000
PPE (1,010 + 2,210)	3,220,000
MV (510 + 345)	855,000
	7,871,750
CA Inventory (890 – 7.2 + 352)	1,234,800
Receivables (1,372 – 75+ 514)	1,811,000
Cash (89 + 39 + 51)	179,000
	11,096,550
Shares	1,000,000
Revaluation	2,500,000
Cons ret earnings (W3)	5,057,237
Non-controlling interest (W4)	717,313
NCL	500,000
CL (996 + 362 – 36)	1,322,000
	11,096,550

Practice Answers

Workings

W1 Group structure

A
|
| 75%
S —— 25%

W2 Goodwill

Cost of investment		2,000,000
Nci investment valuation 25% x 500,000 x $3.50		437,500
		2,437,500
Net assets @ doa		
Shares	500,000	
Retained earnings	1,044,000	
		1,544,000
Goodwill		893,500
Impaired 50%		446,750
		446,750
(Nci share of impairment 25% x 446,750		111,687)

W3 Consolidated retained earnings

	August	*Scone*
Per question	4,225,000	2,610,000
pups	(7,200)	–
	4,217,800	2,610,000
– pre acquisition		(1,044,000)
∴ post acquisition		1,566,000
A's share	1,174,500	75%
	5,392,300	
– goodwill impairment	335,063	
	5,057,237	

W4 NCI (25%)

Value @ doa	437,500
Share of post acq ret'd 25% × 1,566,000	391,500
	829,000
Less goodwill impairment	111,687
	717,313

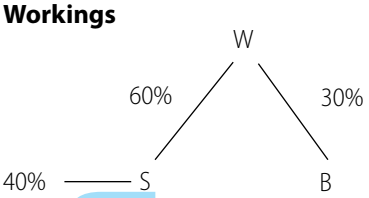
5 Wear

Consolidated Statement of Financial Position as at 31 December 20X4

	$
Investment in Associate (W5A)	138,000
TNCA (370 + 190 + 50 -5)	605,000
Inventory (160 – 1.5 + 100) (W2)	258,500
Receivables (170 + 90)	260,000
Dividend from associate	6,000
Cash (50 + 40)	90,000
	1,357,500
Shares	200,000
Premium	100,000
Cons ret earnings (W3)	716,300
NCI (W4A)	153,200
	1,169,500

CL (100 + 60)	160,000
Div payable	20,000
NCI div pble	8,000
	1,357,500

Workings



W2 Goodwill

		S		B
Cost of investment		128,000		90,000
Nci investment valuation 40% x 210,000		84,000		
		212,000		
Net assets @ doa				
Shares	80,000		50,000	
Premium	80,000		30,000	
Retained earnings	20,000		150,000	
fv adjustments TNCA	50,000		230,000	
inventory	(20,000)		30%	69,000
		210,000		
Goodwill		2,000		21,000
Impaired		2,000		21,000
		–		–

pups

C + π = SP
6,000 (perq)
¼ × 6,000 = 1,500 pup in W

Dividends	W	S	B
Receivables	~~12~~	–	–
	~~6~~		
Ret earnings	(20)	(20)	(20)
	12		
	6		
Pbles	20	~~20~~	~~20~~
		8	14

W3 Consolidated retained earnings

		W	S	B
per question		568,000	200,000	400,000
dividend pble		(20,000)	(20,000)	(20,000)
dividend rbles				
from S		12,000		
from B		6,000		
pup		(1,500)		
fv adjustments		–	50,000	–
depreciation		–	(5,000)	–
		564,500	225,000	380,000
- pre acquisition			(50,000)	(150,000)
∴ post acq			175,000	230,000
W's share	S	105,000	60%	30%
	B	69,000		
		738,500		

– goodwill impairment	S	60% x 2,000	(1,200)
			737,300
	B	100% x 21,000	21,000
			716,300

W4A NCI (40%)

Value @ doa	84,000
Share of post acq ret'd 40% x 175,000	70,000
	154,000
Less goodwill impairment 40% × 2,000	800
	153,200

W5A Investment in Associate (30%)

Cost	90,000
Share of post acq ret'd 30% × 230,000	69,000
	159,000
Less impairment	21,000
	138,000

6 Orange and Nancy

Consolidated Statement of Comprehensive Income for the year ended 30 June, 20X8

	$
Revenue (403,400 + 193,000 –40,000)	556,400
Cost of sales (201,400 + 92,600 – 40,000 + 4,000)	258,000
	298,400
Distribution costs (16,000 + 14,600)	(30,600)
Administrative expenses (24,250 + 17,800)	(42,050)
	225,750
Tax (61,750 + 22,000)	(83,750)
Profit after tax	142,000

Statement of Changes in Equity (extract) for the year ended 30 June, 20X8

	Ret earnings	*NCI*
Brought forward (W3 b/f)	190,000	24,400
for the year	142,000	–
	332,000	24,400
– dividends	(40,000)	(10,000)
	292,000	14,400
NCI (W4B)	(16,800)	16,800
	275,200	31,200

W1 O
| 60%
N —— 40%

W2 Goodwill – "question says to be ignored"

pups

C	+	π	=	SP
100		25		125

$^{25}/_{125} \times ½ \times 40{,}000$ = 4,000 pup in Nancy

W3 Consolidated retained earnings (proof of the retained earnings in the Statement of Changes in Equity)

	O	*N*
per question	232,000	82,000
– pup		(4,000)
	232,000	78,000
– pre acq		(16,000)
		62,000
our share	37,200	60%
	269,200	
dividend from N	6,000	
	275,200	

W3 Brought forward

	O	*N*
per question	163,000	61,000
– pre acq		(16,000)
∴ post acq		45,000
our share	27,000	60%
	190,000	

W4A NCI (40%)

40% × (46,000 – 4,000)	
40% × 42,000	16,800

7 Dole

(a) Statement of Financial Position (extracts)

	A	*B*	*C*	*Total*
	$	*$*	*$*	*$*
Amounts due from customers	80,000	–	–	80,000
Amounts due to customers	–	(25,000)	(45,000)	(70,000)
Statement of Comprehensive Income (extracts)				
Revenue recognised	600,000	500,000	350,000	1,450,000
Costs recognised	(480,000)	(600,000)	(315,000)	(1,395,000)
Profit recognised	120,000	(100,000)	35,000	55,000

W1		60%	50%	35%
		A	*B*	*C*
	Revenue recognised	600,000	500,000	350,000
	Cost recognised	(480,000)	(600,000)	(315,000)
		120,000	(100,000)	35,000
W2	Costs to date	500,000	550,000	320,000
	Attributable profit	120,000	(100,000)	35,000
		620,000	450,000	355,000
	Amounts invoiced	(540,000)	(475,000)	(400,000)
		80,000	(25,000)	(45,000)

8 Nice

(a) Statement of comprehensive income

	20X9
	$'000
Surplus on revaluation of properties	120
Net gains not recognised in the Statement of Income	120
Net profit for the year (566 - 50)	516
Total recognised gains and losses	636

Note: The effect of the change in accounting policy would be shown at the foot of the comparative statement of recognised income and expense (not required by the question).

(b) Statement of Changes in Equity

	Share Capital	*Share Premium*	*Revaluation Surplus*	*Retained Earnings*	*Total*
	$'000	*$'000*	*$'000*	*$'000*	*$'000*
Balance at 1 January 20X9	2,800	1,150	750	2,120	6,820
Change in accounting policy			(40)	40	–
Restated balance	2,800	1,150	710	2,160	6,820
Surplus on revaluation of properties			120		120
Net gains not recognised in the Statement of Income			120		120
Net profit for the year (566 - 50)				516	516
Dividends				(200)	(200)
Transfer of realised profit (W1)			(35)	35	-
Issue of share capital	600	(40)			560
Balance at 31 December 20X9	3,400	1,110	795	2,511	7,816

(W1) Calculation of profit realised on sale of revalued asset

Revaluation recognised in past	50,000
Less: amounts transferred to retained earnings:	
(80,000/10 - 30,000/10) × 3	(15,000)
	35,000

9 Tours

Tours and Bite

On the Statement of Financial Position (extracts) at 31 December, 200X2

		T	*B*
TNCA	(12,000 – 2 × 800)	10,600	10,600
LTL	Finance lease creditors	7,740	8,232
CL	Finance lease creditors	1,178	1,341
	Accrued finance lease interest	826	

On the Statement of Comprehensive Income (extracts) for the year ended 31 December, 20X2

Operating expenses, depreciation	800	800
Finance charges, finance lease interest	826	750

In the Notes to the Financial Statements (extracts) for the year ended 31 December, 20X2

Accounting policy note about depreciation

A note reconciling minimum lease payments with the present value

Payable within one year	2,004	2,004
More than one year, less than five	8,016	8,016
More than five years	2,004	2,004
	12,024	12,024

Less interest not yet due	3,106	2,451
	8,918	9,573
Present value of finance lease liabilities		
Within one year	1,831	1,873
More than one year, less than five	5,909	6,359
More than one year	1,178	1,341
	8,918	9,573

A note concerning the movement on TNCA

	T	*B*
Cost brought forward, 1 January, 20X2	12,000	12,000
Aditions at cost	–	–
Disposals at cost	–	–
Cost carried forward, 31 December, 20X2	12,000	12,000
Depreciation brought forward,1 January, 20X2	800	800
For the year	800	800
	1,600	1,600
On disposals	–	–
Depreciation carried forward, 31 December 20X2	1,600	1,600
Net book value at 31 December, 20X2	10,400	10,400
Net book value at 1 January 20X2	11,200	11,200

Workings

	T	*B*
Cost at 1 January, 20X1	12,000	12,000
Deposit	(2,004)	–
	9,996	12,000
Interest to 31 December 20X1	926	831
	10,922	12,831
Paid on 31 December, 20X1	–	2,004
Balance at 31 December, 20X1	10,992	10,827
Paid on 1 January, 20X2	(2,004)	–
	8,918	10,827
Interest to 31 December, 20X2	826	750
	9,744	11,577
Paid on 31 December, 20X2	–	(2,004)
Balance at 31 December, 20X2	9,744	9,573
Paid on 1 January, 20X3	(2,004)	–
	7,740	9,573
Interest to 31 December, 20X3	717	663
	8,457	10,236
Paid on 31 December, 20X3	–	(2,004)
Balance at 31 December, 20X3	8,457	8,232

10 Dial

Deferred tax liability

	20X6
	$'000
Amount charged to Statement of Comprehensive Income (W1)	186
Amount charged to equity (W2) *	252
Balance c/d	438

* The deferred tax on the revaluation gain will be charged to the revaluation surplus as IAS 12 requires deferred tax on gains recognised directly in equity to be charged or credited directly to equity.

Workings

1 Tax depreciation

	$'000	*$'000*
At 30 September 20X6:		
NBV		1,185
Tax WDV:		
At 1 October 20X5	405	
Expenditure in year	290	
	695	
Less: WDA (25%)	(174)	
		(521)
Cumulative timing difference		664
	@ 28%=	186

2 Revaluation surplus

Temporary difference ($1,500,000 – $600,000) @ 28% = $252,000

11 Code

Statement of Cash Flows for the year ended 31 October 20x2

Cash flows from operating activities		
Net profit before taxation	580	
Adjustments for:		
Depreciation	375	
Loss on disposal of assets	20	
Interest expense	63	
Operating profit before working capital changes	1038	
Increase in inventories	(44)	
Increase in receivables	(46)	
Decrease in payables	(61)	
Cash generated from operations	887	
Interest paid	(63)	
Dividend paid	(210)	
Tax paid	(100)	
Net cash flow from operating activities		514
Cash flows from investing activities		
Purchase of property, plant and equipment	(660)	
Proceeds from sale of property, plant and equipment	240	
Net cash flow from investing activities		(420)
Cash flows from financing activities		
Proceeds from issue of shares	300	
Redemption of preference shares	(200)	
Repayment of long term loan	(250)	
Net cash flow from financing activities		(150)
Net decrease in cash and cash equivalents		(56)

Cash and cash equivalents at beginning 1 November, 20X1	20
Cash and cash equivalents at 31 October, 20X2	(36)

Note to the Statement of Cash Flows

Cash and cash equivalents

Cash and cash equivalents consist of cash at bank and overdrafts and comprise the following Statement of Financial Position amounts.

	20X2	*20X1*
Cash at bank	–	20
Overdrafts	(36)	–
Cash and cash equivalents	(36)	20

Workings

W1 Additions to non current assets

Land & Buildings

	$'000		*$'000*
b/f Land	500	Disposal (250 - 155)	95
Buildings	1,400	Depreciation	105
∴ Additions	70	c/f Land	570
		Buildings	1,200
	1,970		1,970

Plant & Equipment

	$'000		*$'000*
b/f	740	Disposal (220 - 105)	115
		Depreciation	205
∴ Additions	410		
		c/f	830
	1,150		1,150

Vehicle

	$'000		*$'000*
b/f	420	Disposal (120 - 70)	50
		Depreciation	65
∴ Additions	180		
		c/f	485
	600		600

Total additions (70 + 410+ 180)=$660

W2 Proceeds from disposal of non-current assets

Buildings	NBV	95
	+ profit	20
		115
P&E	NBV	115
	- loss	(30)
		85
Vehicles	NBV	50
	- loss	(10)
		40

Total proceeds (115 + 85 + 40)=$240

Practice Answers

W3 Dividends paid

Proposed preference dividend in 20X1 represents full dividend due for year (7.5% of $400), as does proposed preference dividend in 20X2 (7.5% of $200). Therefore preference dividend paid in 20X2 is $30,000.

Equity dividends

Equity dividends

	$'000		*$'000*
∴ Cash	180	b/f	180
		Statement of Comprehensive Income (215 - 15)	200
c/f	200		
	380		380

In schedule format

	Land cost			***Building cost***	***Buildings dep***
b/f	500			1,750	350
c/f	570		sold	(250)	(155)
∴ cash	70			1,500	195
			depn		105
			c/f	1,500	300

	Plant & equipment cost	***Plant & equipment dep***		***Motor vehicles cost***	***Motor vehicles dep***
b/f	1,205	465		730	310
sold	(220)	(105)	sold	(120)	(70)
	985	360		610	240
depn	–	205	dep	–	65
	985	565		610	305
c/f	1,395	565	c/f	790	305
∴ cash	410		∴ cash	180	

	Dividends		***Tax***
b/f	210	b/f	100
this year	215	this year	140
	425		240
c/f	215	c/f	140
∴ cash	210	∴ cash	100

12 Jauciu

Basic eps $\frac{420{,}000}{2{,}032{,}910}$ = 20.66c

Last year as disclosed 25c

As restated ($25 \times \frac{7}{10} \times \frac{3.65}{4}$) 15.97c

Diluted eps 15.82c

Working

D	***N***	***P***		***F***	***W***
1.9.08	1,000,000	5/12	10/7	4/3.65	652.316
31.1.09	1,400,000	2/12	10/7	4/3.65	365,297
1.4.09	2,000,000	2/12		4/3.65	365,297
31.5.09	2,600,000	3/12			650,000
					2,032,910

Rights fraction calculation

10	4	40
3	2.50	7.50
13	3.65	47.50

Rights fraction is ∴ 4/3.65

Dilutions calculations

Options

2,000,000	3	6,000,000
1,500,000	4	6,000,000
500,000	pes and no pee	

Loans

2011	70,000 / 100	× 190	133,000
2012	70,000 / 90	× 185	143,888
2015	70,000 / 120	× 240	140,000

∴ take the 2012 conversion of 143,888 pes

70,000 × 7%	=	4,900
less tax @ 28%		1,372
net saving		3,528 pee

	shares	*earnings*	*eps*	
	2,032,910	420,000	20.66	
options	500,000	–		
	2,532,910	420,000	16.58	
loan	143,888	3,528		
	2,676,798	423,528	15.82	deps

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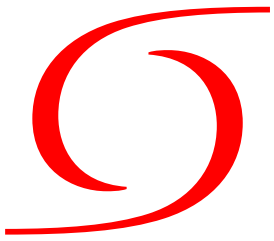

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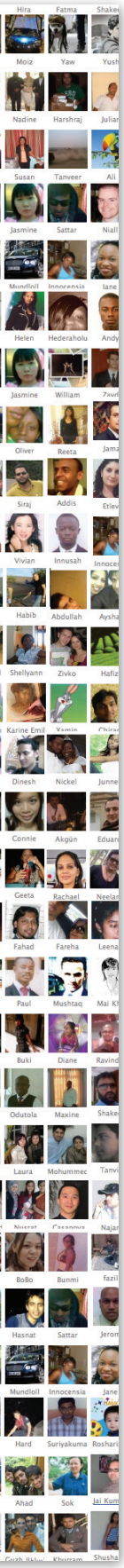

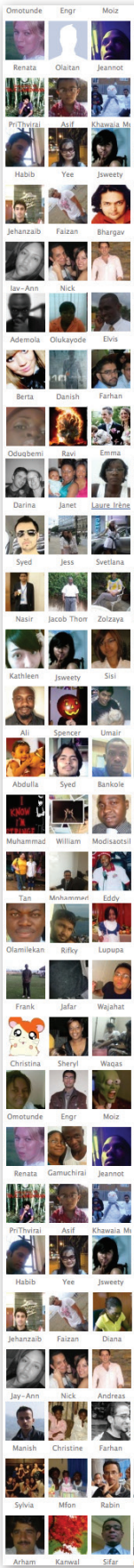

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