THE PROFESSIONALS' ACADEMY OF COMMERCE

Advanced Accounting & Financial Reporting

Mock Exam Summer-2015 **May 21, 2015**
Module : E (Additional reading time - 15 minutes) **100 marks – 3 hours**

Q-1 Flux, a public limited company, operates in the manufacturing sector. The draft statements of financial position of the group companies are as follows at 30 November 201:

	Flux Rs. m	**Electra** Rs. m	**Fusion** Rs. m
Assets:			
Non-current assets			
Property, plant and equipment	257	311	238
Investments in subsidiaries			
Electra	340		
Fusion	134		
Investment in Star	16		
	747	311	238
Current assets	475	304	141
Total assets	1,222	615	379
Equity and liabilities:			
Share capital	430	230	150
Retained earnings	410	170	65
Other components of equity	22	14	17
Total equity	862	414	232
Non-current liabilities	172	124	38
Current liabilities			
Trade and other payables	178	71	105
Provisions for liabilities	10	6	4
Total current liabilities	188	77	109
Total liabilities	360	201	147
Total equity and liabilities	1,222	615	379

The following information is relevant to the preparation of the group financial statements:

(i) On 1 June 2012, Flux acquired 60% of the equity interests of Electra, a public limited company. The purchase consideration comprised cash of Rs.250 million. Excluding the franchise referred to below, the fair value of the identifiable net assets was Rs.360 million. The excess of the fair value of the net assets is due to an increase in the value of non-depreciable land.

Electra held a franchise right, which at 1 June 2012 had a fair value of Rs.10 million. This had not been recognized in the financial statements of Electra. The franchise agreement had a remaining term of five years to run at that date and is not renewable. Electra still holds this franchise at the year-end.

Flux wishes to use the 'full goodwill' method for all acquisitions. The fair value of the non-controlling interest in Electra was Rs.150 million on 1 June 2012. The retained earnings of Electra were Rs.115 million and other components of equity were Rs.10 million at the date of acquisition.

Flux acquired a further 20% interest from the non-controlling interests in Electra on 30 November 2013 for a cash consideration of Rs.90 million.

(ii) On 31 July 2012, Flux acquired a 100% of the equity interests of Fusion for a cash consideration of Rs.214 million. The identifiable net assets of Fusion had a provisional fair value of Rs.202 million, including any contingent liabilities. At the time of the business combination, Fusion had a contingent liability with a fair value of Rs.30 million. At 30 November 2013, the contingent liability met the

recognition criteria of IAS 37 'Provisions, Contingent Liabilities and Contingent Assets' and the revised estimate of this liability was Rs.25 million. The accountant of Fusion is yet to account for this revised liability.

However, Flux had not completed the valuation of an element of property, plant and equipment of Fusion at 31 July 2012 and the valuation was not completed by 30 November 2012. The valuation was received on 30 June 2013 and the excess of the fair value over book value at the date of acquisition was estimated at Rs.4 million. The asset had a useful economic life of 10 years at 31 July 2012.

The retained earnings of Fusion were Rs.73 million and other components of equity were Rs.9 million at 31 July 2012 before any adjustment for the contingent liability.

On 30 November 2013, Flux disposed of 25% of its equity interest in Fusion to the non-controlling interest for a consideration of Rs.80 million. The disposal proceeds had been credited to the cost of the investment in the statement of financial position.

(iii) On 30 June 2012, Flux had acquired a 100% interest in Star, a public limited company, for a cash consideration of Rs.39 million. Star's identifiable net assets were fair valued at Rs.32 million.

On 30 November 2013, Flux disposed of 60% of the equity of Star when its identifiable net assets were Rs.36 million. Of the increase in net assets, Rs.3 million had been reported in profit or loss and Rs.1 million had been reported in comprehensive income as profit on an available-for-sale asset. The sale proceeds were Rs.23 million and the remaining equity interest was fair valued at Rs.13 million. Flux could still exert significant influence after the disposal of the interest. The only accounting entry made in Flux's financial statements was to increase cash and reduce the cost of the investment in Star.

(iv) Flux acquired a plot of land on 1 December 2012 in an area where the land is expected to rise significantly in value if plans for regeneration go ahead in the area. The land is currently held at cost of Rs.6 million in property, plant and equipment until Flux decides what should be done with the land. The market value of the land at 30 November 2013 was Rs.8 million but as at 15 December 2013, this had reduced to Rs.7 million as there was some uncertainty surrounding the viability of the regeneration plan.

(v) Flux anticipates that it will be fined Rs.1 million by the local regulator for environmental pollution. It also anticipates that it will have to pay compensation to local residents of Rs.6 million although this is only the best estimate of that liability. In addition, the regulator has requested that certain changes be made to the manufacturing process in order to make the process more environmentally friendly. This is anticipated to cost the company Rs.4 million.

(vi) Flux has a property located in a foreign country, which was acquired at a cost of 8 million SK on 30 November 2012 when the exchange rate was Re.1 = 2 SK. At 30 November 2013, the property was revalued to 12 million SK. The exchange rate at 30 November 2013 was Re.1 = 1.5 SK. The property was being carried at its value as at 30 November 2012. The company policy is to revalue property, plant and equipment whenever material differences exist between book and fair value. Depreciation on the property can be assumed to be immaterial.

(vii) Flux has prepared a plan for reorganizing the parent company's own operations. The board of directors has discussed the plan but further work has to be carried out before they can approve it. However, Flux has made a public announcement as regards the reorganization and wishes to make a reorganization provision at 30 November 2013 of Rs.30 million. The plan will generate cost savings. The directors have calculated the value in use of the net assets (total equity) of the parent company as being Rs.870 million if the reorganization takes place and Rs.830 million if the reorganization does not take place. Flux is concerned that the parent company's property, plant and equipment have lost value during the period because of a decline in property prices in the region and feel that any impairment charge would relate to these assets. There is no reserve within other equity relating to prior revaluation of these non-current assets.

Required:

(a) Calculate the gain or loss arising on the disposal of the equity interest in Star. ***(03)***

(b) Prepare a consolidated statement of financial position of the Flux Group at 30 November 2013 in accordance with International Financial Reporting Standards. *(22)*

Q-2 ABC Group recognized a gain of Rs.160,000 on the translation of the financial statements of a 75% owned foreign subsidiary for the year ended 31 December, 2013. This gain is found to be made up as follows:

	Rs.
Gain on opening net assets:	
Non-current assets	90,000
Inventories	30,000
Receivables	50,000
Payables	(40,000)
Cash	30,000
	160,000

ABC Group recognized a loss of Rs.70,000 on retranslating the parent entity's foreign currency loan. This loss has been disclosed as OCI and charged to reserves in the draft financial statements.

Consolidated statements of financial position
As at 31 December

	2013 Rs.000	2012 Rs.000
Non-current assets	2,100	1,700
Inventories	650	480
Receivables	990	800
Cash	500	160
	4,240	**3,140**
Share Capital	1,000	1,000
Consolidated reserves	1,600	770
	2,600	**1,770**
Non-controlling interest	520	370
Equity	**3,120**	**2,140**
Long-term loan	250	180
Payables	870	820
	4,240	**3,140**

There were no non-current asset disposals during the year.

Consolidated statements of profit or loss
For the year ended 31 December 2013

	Rs.000
Profit before tax (after depreciation of Rs.220,000)	2,170
Tax	(650)
Group profit for the year	**1,520**
Profit attributable to:	
Owners of the parent	1,260
Non-controlling interest	260
Net profit for the period	**1,520**

Note:

The dividend paid during the year was Rs.480,000

Required:
Prepare a statement of cash flows for the year ended 31 December 2013. *(10)*

Q-3 (a) Ali sells its freehold office premises and leases them back on a 20 year operating lease. The sale took place on 1 January 2013, and the company has a 31 December year-end.

The details of the scheme are as follows:	Rs.000	
Proceeds of sale	10,000	
Fair value of the asset at the time of sale	9,000	
Carrying amount at the time of sale	3,500	
Lease payments (annual rental)	480	
Market rate for similar premises (annual rental)	410	***(02)***

(b) A socially responsible multinational corporation (MNC) decided to construct a tunnel that will link two sides of the village that were separated by a natural disaster years ago. Realizing its role as a good corporate citizen, the MNC has been in this village for a couple of years exploring oil and gas in the nearby offshore area. The tunnel would take two years to build and the total capital outlay needed for the construction would be not less than Rs.20 million. To allow itself a margin of safety, the MNC borrowed Rs.22 million from three sources and used the extra Rs.2 million for its working capital purposes. Financing was arranged in this way:

- Bank term loans: Rs.5 million at 7% per annum
- Institutional borrowings: Rs.7 million at 8% per annum
- Corporate bonds: Rs.10 million at 9% per annum

In the first phase of the construction of the tunnel, there were idle funds of Rs.10 million, which the MNC invested for a period of six months. Income from this investment was Rs.500,000. ***(02)***

(c) Ali & Co. makes an award to employees on 1 January, 2013. Employees will receive 500 shares in Ali & Co. at the end of three years subject to a service condition (remain employed for three years) and a market condition (share price target of Rs.5). After grant date, there has been a decline in the market value of the shares of Ali & Co.

To ensure the award continues to incentivize employees, during year 2 on 12 April, 2014. Ali & Co. modifies the market condition to a share price target of Rs.3.

The fair values are as follows:

- 1 January 2013 at grant date Rs.20
- 12 April 2014 immediately before modification Rs.10
- 12 April 2014 immediately after modification Rs.30 ***(02)***

(d) An asset is sold in two different active markets at different prices. An entity enters into transactions in both markets and can access the price in those markets for the asset at the measurement date. If neither market is the principal market for the asset the fair value of the asset would be measured using the price in the most advantageous market.

The most advantageous market is the market that maximizes the amount that would be received to sell the asset, after taking into account transaction costs and transport costs (i.e., the net amount that would be received in the respective markets).

	Market A	**Market B**	
Price that would be received	Rs. 26	Rs. 25	
Transaction costs in that market	Rs. (3)	Rs. (1)	
Costs to transport the asset to the market	Rs. (2)	Rs. (2)	
Net amount that would be received	Rs. 21	Rs. 22	***(02)***

(e) On January 1, 2013, Entity A enters into a forward contract to purchase on January 1, 2015, a specified number of barrels of oil at a fixed price. Entity A is speculating that the price of oil will increase and plans to net settle the contract if the price increases. Entity A does not pay anything to enter into the forward contract on January 1, 2013. Entity A does not designate the forward contract as a hedging instrument.

At the end of 2013, the fair value of the forward contract has increased to Rs.400,000. At the end of 2014, the fair value of the forward contract has declined to Rs.350,000. ***(02)***

Required:
Please advise accounting treatment as per relevant IFRSs.

Q-4 In year 1, Malik Build Inc. was invited to tender for the construction of a residential block and connected shopping arcade with common plaza and garden and play areas. Tenders were required to detail the costs of each element separately, but it was clear that only one contractor would win the entire contract due to the interrelated aspects of the development.

During year 1, Malik Build Inc. management traveled to the United States to visit three possible designers in order to obtain their preliminary design proposals, of which only one would be selected. The cost of the visit was Rs.20,000. Later in year 1, having selected one designer, Malik Build Inc. returned to the United States to clarify design details and request construction of a scale model in order to make a presentation of the tender to the ultimate customer. The cost of the second trip was Rs.15,000.

During year 2, but before its year 1 financial statements were authorized for issue, Malik Build Inc. was notified that it had been awarded the contract. However, the contract was not signed until after the year 1 financial statements were issued.

The contract was for a total price of Rs.16 million, comprising Rs.9 million for the residential block, Rs.5 million for the shopping arcade, and Rs.2 million for the common plaza, garden, and play area. A mobilization advance of Rs.1 million would be paid at the outset, Rs.1 million was payable at the end of year 2, Rs.5 million at the end of year 3, and Rs.8 million was payable at the end of year 4, at which point the development would be complete and Rs.1 million was to be held back as a retention for one year.

Malik Build Inc. initially estimated that the total cost of the project would be Rs.12 million, of which Rs.7 million would be for the residential block, Rs.4 million for the shopping arcade, and Rs.1 million for the plaza, gardens, and play area. Included in this cost is Rs.1 million of plant acquired specifically for the project that could not be used subsequently. The estimated residual value of this plant at the end of the contract was Rs.100,000. Also included in the overall cost was 30 months of depreciation on general plant and equipment already owned by Malik Build Inc. at Rs.50,000 per month. The on-site accounts staff cost included in the estimate was Rs.5,000 per month. Their role was to maintain and record time cards of workers and receive and issue materials.

Costs incurred at each year-end were

	Year 2	***Year 3***	***Year 4***	***Total***
	Rs.	***Rs.***	***Rs.***	***Rs.***
Residential block	1,000,000	3,000,000	3,000,000	7,000,000
Shopping arcade	500,000	1,800,000	1,700,000	4,000,000
Plaza, gardens, & play area	--	200,000	800,000	1,000,000
Total	1,500,000	5,000,000	5,500,000	12,000,000

The costs at the end of year 2 include Rs.250,000 of materials delivered to the site for use in year 3.

The Rs.200,000 in year 3 for the plaza, gardens, and play area was an advance to subcontractors who would mobilize in year 4.

During year 3, due to a fire at the neighboring plot, the police cordoned off the whole area for a month while investigations were conducted. During this time all plant and equipment remained idle on site.

However, work continued in Malik Build Inc.'s workshop and yard.

During year 3, the customer requested a variation in the contract with a value of Rs.1 million and a cost of Rs.750,000. However, the variation was not approved by the customer until after Malik Build Inc.'s year 3 financial statements were authorized for issue. Malik Build Inc. incurred the extra costs for the variation in year 3.

Required
Provide Malik Build Inc.'s income statement and the amounts that should be presented in the balance sheet for each of the years 1, 2, 3 and 4. ***(17)***

Q-5 Extracts from group financial statements of AB, a public limited company, year ended April 30, 2013.

	Rs.m
Profit from continuing operations	35,000
Loss on discontinued operations (tax relief Rs.500 million)	(1,500)
Income tax	(7,500)
Minority interest (loss on discontinued activities Rs.500 million)	(1,500)
Preference share appropriation—dividend (2 years)	(30)
—other	(5)
Share capital at April 30, 2013	
Ordinary shares of Rs.1	1,000
5% Convertible preference shares	300

Other Information

(a) On January 1, 2013, 48 million ordinary shares were issued on the acquisition of CD plc at a valuation of Rs.190 million. If CD earns cumulative profits in excess of Rs.8,000 million up to April 30, 2014, an additional 10 million shares are issuable to the vendors. If the profits do not reach that amount, then only 2 million shares are issuable on April 30, 2014.

(b) The profits for the three months to April 30, 2013, are Rs.1,200 million.

(c) On May 11, 2013, there was a bonus issue of one for four ordinary shares. The financial statements are made up to April 30, 2013, and had not yet been published.

(d) The company has a share option scheme. The directors exercised options relating to 18 million shares on February 28, 2013, at a price of Rs.3 per share. In addition, options were granted during the year on March 1, 2013, to subscribe for 10 million shares at Rs.2 each. The fair value of the shares on March 1, 2013, was Rs.4, and the average fair value for the year was Rs.5.

(e) The preference shares are convertible into ordinary shares on May 1, 2014, on the basis of one ordinary share for every two preference shares or on May 1, 2015, on the basis of one ordinary share for every four preference shares.

(f) There is a profit share scheme in operation whereby employees receive a bonus of 5% of profits from continuing operations after tax and preference dividends.

(g) XY plc, a 100% owned subsidiary of AB, has in issue 9% convertible bonds of Rs.200 million that can be converted into one ordinary share of AB for every Rs.10 worth of bonds. Income tax is levied at 33%.

Required
Calculate basic and diluted earnings per share. ***(15)***

Q-6 Statement of Financial Position
As at January 1, 2014

	Rs. m
Property, plant, and equipment	7,000
Goodwill	3,000
Intangible assets	2,000
Financial assets	6,000
Total noncurrent assets	18,000
Trade and other receivables	7,000
Other receivables	1,600
Cash and cash equivalents	700
Total current assets	9,300
Total assets	27,300
Issued capital	6,000
Revaluation reserve	1,500
Retained earnings	6,130
Total equity	13,630
Interest-bearing loans	8,000
Trade and other payables	4,000
Employee benefits	1,000
Current tax liability	70
Deferred tax liability	600
Total liabilities	13,670
Total equity and liabilities	27,300

(a) Tax bases of the above assets and liabilities are the same as their carrying amounts except for
Tax base

	Rs. m
Property, plant, and equipment	1,400
Trade receivables	7,500
Interest-bearing loans	8,500
Financial assets	7,000

- The intangible assets are development costs that are allowed for tax purposes when the cost is incurred. The costs were incurred in 2012.
- Included in trade and other payables is an accrual for compensation to be paid to employees.

It is allowed for taxation when the payment is made and totals Rs.200 million.

(b) During 2013, a building was revalued. At January 1, 2014, there was Rs.1500 million remaining in the revaluation reserve in respect of this building.

(c) The following adjustments to the financial statements will have to be made to comply with IFRSs on January 1, 2014:

- Intangible assets of Rs.400 million do not qualify for recognition under IFRS 36.
- The financial assets are all classified as at fair value through profit or loss and their fair value is Rs.6,500 million, which is to be included in the IFRS accounts.
- A pension liability of Rs.50 million is to be recognized under IFRS 1 that was not recognized previously. The tax base of the liability is zero.

(d) The entity is likely to be very profitable in the future.

Required:
Calculate the deferred tax provision at January 1, 2014, showing the amount of the adjustment required to the deferred tax provision and any amounts to be charged to revaluation reserve. (Assume a tax rate of 30%.) ***(08)***

Q-7 On August 1, 2006, Entity A purchased a two-year bond, which it classified as available for sale. The bond had a stated principal amount of Rs.100,000, which Entity A will receive on August 1, 2008. The stated coupon interest rate was 10% per year, which is paid semiannually on December 31 and July 31. The bond was purchased at a quoted annual yield of 8% on a bond-equivalent yield basis.

Required;

(a) What price did Entity A pay for the bond?

(b) Did Entity A purchase the bond at par, at a discount, or at a premium?

(c) Prepare the journal entry at the date Entity A purchased the bond. (Entity A paid cash to acquire the bond. Assume that no transaction costs were paid.)

(d) Prepare a bond amortization schedule for years 2006 to 2008. For each period, show cash interest receivable, recognized interest revenue, amortization of any bond discount or premium, and the carrying amount of the bond at the end of the period.

(e) Prepare the journal entries to record cash interest receivable and interest revenue on July 31, 2007.

(f) If the quoted market yield for the bond changes from 8% to 9% on December 31, 2007, should Entity A recognize an increase, a decrease, or no change in the carrying amount of the bond on that date? If you conclude that the carrying amount should change, compute the change and prepare the corresponding journal entries. ***(15)***

(THE END)