1- $ 1,000,000

The fair value gain of $t million ($9m - $8m) should be taken to the statement of Profit or loss. Costs to sell are ignored and, Since Croft uses the fair value model. no depreciation will be charged on the building.

2- C

Asset held for sale will be measured at lower of carrying amount and fair value' less cost to sell. Once reclassified. the asset held for sale is not depreciated.

	$ M
Cost	45
Depreciation to 30 Sep 20X3	(6)
Depreciation to 1st Apr 20X4 (45*1/15*6/12)	(1.5)
Carrying amount 1 Apr 20X4	37.5

flair value less cost to sell = $ 36.8 million (42,000 * 90%) - 1,000. Therefore the asset is reported at S36.8 million.

3- A

Elements are recognized if recognition provides users with useful financial information. In other words recognition must provide relevant information and faithful representation.

4- C

The prior period error is corrected by restating the comparative amounts for the previous period at their correct value. A note to the accounts should disclose the nature of the error. together with other details

5-

	Accounted for Under IAS 41 Agriculture	Outside the scope of IAS 41 Agriculture
Dairy cattle	*	
Milk	*	
cheese		*

The cheese will be a product which is the result of processing after harvest, so will be outside the scope of IAS 41 Agriculture.

6- A

The business model test must also be passed, which means that the objective is to hold the instrument to collect the cash flows rather than to sell the asset. The others are irrelevant.

7- $200,000

Step 1- Progress

Progress = Cost to date/ Total Cost = 1.6 /(1.6+2.4)= 40 %

Step 2 – revenue

Revenue to recognize = $ 5 M * 40% = $ 2 M.

Step 3 – Statement of Financial Position	$000
Revenue Earned	2,000
Less, Amount Billed	(1,000)
Contract Asset	200

8- A

Deferred Taxation Increase	7,000 (23,000 – 16,000)
Less Tax on Revaluation gain	(3,000) Recognized as OCI (10,000 *30%)
Charge to SPL	4,000

Tax Expense:

Current Year Estimate	12,000
Prior year Overprovision	(7,000)
Deferred Tax as above	4,000
Charge for the Year	9,000

If you chose B, you have used the full deferred tax increase. If you chose C you have added the overprovision. if you choose D you have deducted the deferred tax movement

9- B

Thy costs associated with ongoing activities (relocation and retraining of employees) should not be provided for.

10- $352,000

The unrealized profit on the non-current asset transfer needs to be removed.

The carrying amount at the year-end after the transfer is $32,000 ($ 40,000 Less 1 Year's Depreciation).

The carrying amount of the asset if it had not been transferred would have been $24,000 ($30,000 Less one Year's Depreciation).

Therefore, the unrealized profit on the nun-current asset is $ 8,000 ($ 32,000 -$ 24,000) the total property plant and equipment is $ 300,000 + $60,000 -$ 8,000 = $ 352,000

11- B

Beasant own 30% of Arnie's shares, which is 30,000 shares (30% of Arnie's 100.000 shares). As as Beasant issued 1 share for every 3 purchased, Beasant issued 10,000 shares. There had a
market value of $4.50 and were therefore worth $45.000.

In valuing an associate Beasant must include 30% of Arnie's post-acquisition movement in net assets. A me has made a post-acquisition loss of S40,000 (net assets at acquisition were $500,000 and net assets as 31 December were S460,000). Therefore Beasant's share of this is a $ 12,000 loss (30%).

Cost of Investment	$45,000
Share of Post-acquisition Loss	($12,000)
Investment in Associate	$33,000

If you chose D. you based the consideration on 30,000 Shares rather than 10,000. If you chose C. you have ignored share capital mom the net assets movement. if you those A. you have used the wrong share price for consideration.

12- C, D

The fair value of deferred consideration is its present value. Fair values are applied to the Subsidiary's assets, liabilities and contingent liabilities.

While the use of fair value seems to not comply with the historical cost principle, this will effectively form pan of the cost of the subsidiary to the parent, so the principle is still applied. Depreciation will not increase if the fair value of assets is lower than the current carrying amount. Patents can be recorded as intangible assets as they are separable.

13- C

Return on capital employed is calculated as profit from operations/capital employed Capital employed consists of debt and equity.

The deferred tax and payables ore not included Therefore the return on capital employed = $240,000/$900,000= 26.7%

14- B, C

Rising costs are likely to affect the whole industry, and would still mean that Quartile could be compared to the sector. As the whole

15-

Amortization of Government Grant	Receipt of grant
	Cash received from grant $300,000 in investing activities
Decrease of $ 100,000 to cash generated from operations	

The release of government grant should be deducted within the reconciliation of cash generated from operations, as this represents non-cash income. The grant received of $ 300,000 can be calculated using a working as shown below.

Grant liability

		b/f	900,000
ıse to SPL	100,000	**Receipt of grant (balance)**	**300,000**
	1,100,000		
	1.200.000		1.200.000

ANSWERS TO OBJECTIVE CASE QUESTIONS - SECTION B

1- A

As Speculate uses the fair value model for investment Properties, the asset should be revalued to fair value before being classed as an investment property. The gain on revaluation should be taken to other comprehensive income. as the asset is being revalued while held as Property. plant and Equipment.

At 1 October. the carrying amount of the asset is $1,950. being $2 million less 6 months' depreciation. As the fair value at 1 October is S2.3 million, this leads to a S350,000 gain which will be recorded in other comprehensive income.

2- B

Investment properties can be accounted for under the cost or fair value model but not the revaluation model, which applies to property, plant and equipment.

3- $ 190,000

	$ 000
Gain on investment properties: A (2,340-2,300)	40
B (1,650 – 1,500)	150

4-

Individual	*	Consolidated	*
Investment Property	*	Investment property	
Property, plant & equipment		Progeny. plant & equipment	*
Within goodwill		Cancelled as an intro – group item	

In the individual financial statements Speculate would treat property B as an investment, but in Speculate's consolidated financial statements property B would be accounted for under IAS 16 Property, Plant and Equipment and be classified as owns-occupied. The group is regarded as a single entity, and the group use the building.

5- B

If Speculate uses the colt model. the asset would be transferred to investment properties at its carrying amount and then depreciated over its remaining life. This would that the asset would have a year's depreciation applied to it, 6 months while held as property, plant and equipment. 6 months while held as an investment property. Fair values would be irrelevant.

The depreciation would therefore be $ 2 million/20 years = $100,000, giving a carrying amount of $ 1.9 Million.
if you selected A, you have only accounted for depreciation for 6 months. if you selected C or D. you have applied depreciation to the fair value of the asset.

1- B. C

Accounting policies should only be changed if required by a new IFRS Standards or if doing
so results in the production of more reliable and relevant information.

2- The change in useful life of the plant will be a change in accounting estimate and should be applied prospectively.
3- A change in accounting policy must be accounted for as if the new policy had always been in place retrospectively. in this case, for the year ended 30 September 20X9. both the opening and closing inventories would need to be measured at AVCO which would reduce reported profit by the movement in the values of the opening and closing inventories of $400,000 ($20million - $18 million) – ($15 million - $13.4 Million).

The other effect of the change would be on the retained earnings brought forward ac 1 October 20X8. These will be restated (reduced) by the effect of the reduced inventory value at 30 September 20X8 i.e. $1.6 million ($15 Million — $13.4 million). This adjustment would be shown in the statement of changes in equity.

4- $88,000

The inventories should be valued at the lower of cost and net realizable value (NRV). The items have a cost of $ 100,000 (20,000 at $5 each). The NRV is $ 88,000, being the 20,000 units at their net selling price of $44 ($55 less 20% commission).

5- B

The inventories should be held at the cost of $80,000 as the net realisable value of $150,000 less $20,000 to complete would be higher than the cost. The replacement cost at $50,000 is irrelevant

1- C

To recognize a provision, it must be probable that an outflow of resources will be required.

2- C

A provision is recognized at the best estimate of the expenditure required. For a single obligation, this should be the most likely outcome.

If you selected answer B you have calculated an expected value. This is used when the provision being measured involves a large population of items.

3- $ 840,000

The provisio being measured involves a large population of items. So an expected value must be calculated.

(100,000*6%*$100)+(100,000*8%*$30)= $ 840,000.

4- A

The employees affected have been told about the restructuring and therefore I constructive obligation exists. The provision must not include any costs related to the ongoing activities of the entity. This means that only redundancy payments should be provided for.

5-

	Provision	No Provision
Situation 1		*
Situation 2		*

A provision should not be recognized for situation 1 because it does not give rise to an obligation. Hermione could change its operations in order to avoid the legal requirement to fit smoke filters.

A provision should not be recognized for situation 2. future operating losses can be avoided. meaning that no obligation exists.

Section C

Paradigm

(a) Paradigm - Consolidated statement of financial position as at 31 March 20X3

	$000	$000
Assets		
Non-current assets:		
Property, plant and equipment		
(47,400 + 25,500 - 3,000 fair value + 500 depreciation)		70,400
Goodwill (W3)		8,500
Financial asset: equity investments (7,100 + 3,900)		11,000
		89,900
Current assets		
Inventory (20,400 + 8,400 - 600 PUP (W6))	28,200	
Trade receivables (14,800 + 9,000)	23,800	
Bank	2,100	
		54,100
Total assets		**144,000**
Equity and liabilities		
Equity attributable to owners of the parent Equity shares of $1 each (40,000 + 6,000 (W3))		46,000
Share premium (W3)		6,000
Retained earnings (W5)		33,925
Non-controlling interest (W4)		8,800
Total equity		94,725
10% loan notes (8,000 + 1,500 (W3))		9,500
Current liabilities		
Trade payables (17,600 + 13,000 + 75 interest (W7))	30,675	
Bank overdraft	9,100	
		39,775
Total equity and liabilities		**144,000**

Workings

(W1) Group structure

(W2) Net assets

	At acquisition	At reporting date	Post-acquisition
	$000	$000	$000
Share capital	20,000	20,000	–
Retained earnings	(6,000)	4,000	10,000
Fair value adjustment	(3,000)	(3,000)	–
Fair value depreciation (3,000 × $^{6}/_{36}$)		500	500
Gain on equity investment		700	700
	11,000	22,200	11,200

(W3) Goodwill

	$000
Share exchange ((20,000 × 75%) × $^{2}/_{5}$ × $2)	12,000
10% loan notes (15,000 × $^{\$100}/_{1,000}$)	1,500
Non-controlling interest (20,000 × 25% × $1.20)	6,000
Less: Fair value of net assets at acquisition (W2)	(11,000)
Goodwill on acquisition	8,500

The market value of the shares issued of $12 million would be recorded as $6 million share capital and $6 million share premium as the shares have a nominal value of $1 each and an issue value of $2 each.

(W4) Non-controlling interest

	$000
Fair value on acquisition (W3)	6,000
Post-acquisition profits (11,200 (W2) × 25%)	2,800
	8,800

(W5) Group retained earnings

	$000
Paradigm's retained earnings (19,200 + 7,400)	26,600
Strata's post-acquisition profit (11,200 (W2) × 75%)	8,400
PUP in inventory (4,600 × $^{15}/_{115}$)	(600)
Loss on equity investments (7,500 – 7,100)	(400)
Additional loan note interest (1,500 × 10% × $^{6}/_{12}$)	(75)
	33,925

b. IFRS 3 Business Combinations requires the purchase consideration for an acquired entity to be allocated to the fair value of the assets, liabilities and contingent liabilities acquired (henceforth referred to as net assets) with any residue being allocated to goodwill. This also means that those net assets will be recorded at fair value in the consolidated statement of financial position. This is entirely consistent with the way other net assets are recorded when first transacted (i.e. the initial cost of an asset is normally its fair value). This ensures that individual assets and liabilities are correctly valued in the consolidated statement of financial position. Whilst this may sound obvious, consider what would happen if say a property had a carrying amount of $5 million, but a fair value of $7 million at the date it was acquired. If the carrying amount rather than the fair value was used in the consolidation it would mean that tangible assets (property, plant and equipment) would be understated by $2 million and intangible assets (goodwill) would be overstated by the same amount. There could also be a 'knock-on' effect with incorrect depreciation charges in the years following an acquisition and incorrect calculation of any goodwill impairment. Thus the use of carrying amounts rather than fair values would not give a 'faithful representation' as required by the Framework.

The assistant's comment regarding the inconsistency of value models in the consolidated statement of financial position is a fair point, but it is really a deficiency of the historical cost concept rather than a flawed consolidation technique. Indeed the fair value of the subsidiary's net assets represents the historical cost to the parent. To overcome much of the inconsistency, there would be nothing to prevent the parent from applying the revaluation model to its property, plant and equipment.

ACCA marking guide

		Marks
(a)	Property, plant and equipment	1½
	Goodwill	3½
	Equity investments	1
	Inventory	½
	Receivables	½
	Bank	½
	Equity shares	1
	Share premium	½
	Retained earnings	2½
	Non-controlling interest	1½
	10% loan notes	1
	Trade payables	½
	Bank overdraft	½
(b)	One mark per point made	5
Total		**20**

Bun Co

(a) Inventory adjustment

The disposal of the inventory at a discounted price would be classified as an adjusting event in accordance with IAS® 10 Events After the Reporting Period.

Retail price of inventory $1.5 million

GP margin 20%	$0.3 million
Closing inventory (currently credited to SPL)	$1.2 million

A write down of NRV would require a $0.6 M charge to cost of sales thereby increasing it to $70.6 M and reducing profit from operations to $ 12.56 M.

In the statement of financial position, inventory is written down to $ 3.36 M and equity will be adjusted to $ 32.28 M.

	Bun Co	Sector average
Return on year-end capital employed (12,560/(32,280 + 14,400) × 100)|	26.9%	18.6%
Operating profit margin (12,560/100,800 × 100%)	12.5%	8.6%
Inventory holding period (days) (3,360/70,600 × 365)	17.4 days	4 days
Debt to equity (debt/equity) (14,400/32,280 × 100)|	44.6%	80%
Asset turnover (100,800/46,680)	2.16	2.01

(b) Analysis of financial Performance

Profitability

The primary measure of profitability is the return on capital employed (ROCE) and this shows that Bun Co (26.9%) is outperforming the sector (18.6%). The ROCE measures the operating profit relative to the net assets employed in the business. As a percentage, it would appear that Bun Co is 31% ((26.9 - 18.6)/26.9) more efficient that its competitors. However, this ratio should be treated with caution because Bun Co's capital employed includes its revaluation surplus associated with the property. If Bun Co's competitors did not revalue their property, then the ratio is not directly comparable. For example, if Bun Co's revaluation surplus were to be excluded from capital employed, it would increase ROCE to be even higher than the sector average.

As there is little difference between the asset turnover of Bun Co and that of the sector, it would appear that the main cause of ROCE over-performance is due to a significantly higher operating profit margin (12.5% compared to 8.6%). Offering meal deals is advisable, as the company can still afford to reduce its prices and still make a high operating profit margin compared to the industry sector average. By offering meal deals at reduced prices, Bun Co would look to increase their sales volume and therefore this may help them to control and reduce inventory days.

Alternatively, it may be that Bun Co has better control over its costs (either direct, indirect or both) than its competitors. For example, Bun Co may have lower operating costs. As Bun Co owns 80% of its non-current assets in the form of property, this means that it is not paying any rent, whereas its competitors may be. Bun Co's competitors may prefer to lease premises which could be a more flexible basis on which to run a business, but often more costly.

Financial position (limited to inventory and gearing)

In a company like Bun Co, it is expected that inventory would be turned into cash in a relatively short period of time. Bun Co is taking significantly longer than its competitors to sell its inventory which is being held on average for 17 days instead of four days as per the sector average. The main worry is that the inventory is largely perishable. It may be that, since the acquisition of the brand, Bun Co pursued a higher pricing strategy but this may be having a detrimental impact on the company's ability to move its inventory.

Bun Co's debt to equity at 44.6% is lower than the sector average of 80%. This could be because Bun Co acquired its property which has no associated finance. This also means that there will be smaller amounts of interest charged to the statement of profit or loss but this is difficult to confirm as the extract provided is only to profit from operations. There is a bank loan of $14.4m and, although the bank loan interest rate of 10% might appear quite high, it is lower than the ROCE of 26.9% (which means shareholders are benefiting from the borrowings). Finally, Bun Co also has

sufficient tangible non-current assets to give more than adequate security on any future borrowings. Therefore there appear to be no adverse issues in relation to gearing.

Conclusion

Bun Co is right to be concerned about its declining profitability compared to previous years, but from the analysis compared to the industry sector averages, it seems that Bun Co may be in a strong position. The information shows that Bun Co has a much better profitability compared to the industry, but the worrying issue which could become a long-term problem is the length of time Bun Co is holding inventory. Bun Co should seriously consider the strategy of reducing their prices to enable them to sell more inventory and reduce wastage. Should Bun Co wish to raise finance in the future, it seems to be in a strong position to do so.

(c) Factors which may limit the usefulness of the comparison with business sector averages

It is unlikely that all the companies which have been included in the sector averages will use the same accounting policies. In the example of Bun Co, it is apparent that it has revalued its property. This will increase its capital employed and (probably) lower its gearing (compared to if it did not revalue). Other companies in the sector may carry their property at historical cost.

There could also be differences as Bun Co owns the shop, and yet other companies in the sector may not own the freehold and may just rent the shop space. Dependent on how the depreciation compares to the equivalent rate would lead to differences in the margins experienced by each company.

The accounting dates may not be the same for all the companies. In this example the sector averages are for the year ended 30 June 20X7, whereas Bun Co's are for the year ended 30 December 20X7. If the sector is exposed to seasonal trading (which could be likely if there are cakes made for Christmas orders, large bread orders for Christmas and New Year parties), this could have a significant impact on many ratios, in particular working capital based ratios. To allow for this, perhaps Bun Co could prepare a form of adjusted financial statements to 30 June 20X7.

It may be that the definitions of the ratios have not been consistent across all the companies included in the sector averages (and for Bun Co). This may be a particular problem with ratios like gearing as there are alternative methods used to calculate it (inventory days used costs of sales in the calculation, but industry could use purchases). Often agencies issue guidance on how the ratios should be calculated to minimise these possible inconsistencies. Of particular relevance in this example is that it is unlikely that other bakery stores will have a purchased trademark.

Sector averages are just that: averages. Many of the companies included in the sector may not be a good match to the type of business and strategy of Bun Co. This company not only has bakery stores but cafés too and this may cause distortions if comparing to companies within the sector who do not have the same facilities. Also, some companies may adopt a strategy of high-end specialist loaves, cakes and patisserie goods which have high mark-ups, but usually lower inventory turnover, whereas other companies may adopt a strategy of selling more affordable bread and cakes with lower margins in the expectation of higher volumes.

ACCA marking guide		
		Marks
(a)	Inventory adjustment	2
	Ratios	5
		7
(b)	Profitability	5
	Financial position	4
	Conclusion	1
		10
(c)	Sector comparison limitations	**3**
Total		**20**