P2

Section (1) Compulsory

<u>Question (1)</u>

Background

Port Sudan Co is the parent company of a group with one overseas subsidiary and a financial year end of 31 December 20X2. The functional currency of Port Sudan Co and the presentation currency of the Peony Port Sudan Group is the dollar ($).

The following exhibits provide information relevant to the question:

1/ Functional currency – provides information used to determine the functional currency of Atbara Co, an overseas subsidiary.

2/ Three issues – describes three issues relating to the acquisition of Atbara Co, an overseas subsidiary.

3 /Changes in government regulations – describes changes in government regulations in the country in which Atbara Co. operates.

4/ Draft consolidated SOFP – Draft consolidated statement of financial position (SOFP) for the Port Sudan Group.

This information should be used to answer the question requirements.

1 **– Functional currency**

Atbara Co is a foreign subsidiary of Port Sudan Co with a functional currency of pound. Atbara Co's sales and related costs are predominantly denominated and settled in Sterling Pound (£), Port Sudan Co had previously provided a supporting loan in US dollars to Atbara Co, which had been settled during the year and funds from financial activities are currently generated in pound (£) . Atbara Co.'s board of directors is free to determine its decisions independently from the board of Port Sudan Co.

2/**Three issues**

On 1 January 20X2 Port Sudan Co acquired 75% of the 1.5 million Sterling pound 1 ordinary shares of Atbara Co for $1.1 million, when the retained earnings of Atbara Co were Sterling Pound 4.8 million.

There were no other components of equity. Port Sudan Co determined that the non-controlling interests (NCI) in Atbara Co had a fair value of £ 2.7 million at the acquisition date.

During the year ended 31 December 20X2, Atbara Co reported a loss of Sterling pound 900,000. No dividends were paid or proposed. On 31 December 20X2, , Atbara Co.'s reported total equity (net assets) was sterling pound 5.4 million.

Exchange rates were as follows:

1 Jan 2002	One Dollar Equals	12 Sterling Pound
31 Dec 2002	One Dollar Equals	18 Sterling Pound
Weighted average rate for the year ended 31 December 2002	One Dollar Equals	15 Sterling Pound

Three issues

Goodwill arising on the acquisition of Atbara Co was calculated incorrectly as $725,000. This is also the amount included in the draft consolidated SOFP. In arriving at this figure, the NCI at acquisition was translated and recognised using the exchange rate at 31 December 20X2. The calculation was as follows:

		($000)
Consideration		1,100
NCI at acquisition	(Sterling Pounds 2.7m/18)	150
Fair value of identifiable net assets (pound 6.3m/12)		525
Goodwill at acquisition		725

(ii) At 31 December 20X2, a goodwill impairment of pound 3.3 million was calculated but not recognised in relation to , Atbara Co. The group policy is to translate goodwill impairments at the average rate of exchange. (iii Atbara Co's assets and liabilities (excluding goodwill) were translated into dollars using the exchange rate as at 31 December 20X2. The same exchange rate was used to translate Atbara Co.'s loss for the year ended 31 December 20X2. The resulting total exchange loss of $175,000 has been included in the translation reserve in the draft consolidated SOFP with no entry made to the NCI reserve.

3 – Changes in government regulations

Near the beginning of the following year (the year ended 31 December 20X3), changes were made to government regulations in the country in which Atbara Co is located. This has significantly impacted Atbara Co.'s operations and caused a fall in the value of the pound.

The directors are aware that, due to the changes in government regulations, Atbara Co is no longer permitted to transfer funds to Port Sudan Co. Moreover, government restrictions have been enacted which limit the extent to which Port Sudan Co can exercise rights or governance over Atbara.

4 – Draft consolidated SOFP

Port Sudan **Group**	$000
Assets	
Non-current assets	
Property, plant and equipment	18,500
Goodwill	725
	19,225
Current assets	3,200
Total assets	22,425
Equity	
Share capital	6,000
Retained earnings	15,462.5
Translation reserve (OCI)	(175)
	21,287.5
Non-controlling interest	137.5

Total equity	21,425
Liabilities	
Non-current liabilities	200
Current liabilities	800
Total liabilities	1,000
Total equity and liabilities	22,425

Required:

(a) Using exhibit 1, and in accordance with IAS 21 The Effects of Changes in Foreign Exchange Rates, explain why Atbara Co.'s functional currency is the pound. (5 marks)

(b) With regards to the three issues outlined in exhibit 2:

(i) Discuss, with calculations, how to correct the treatment of Atbara Co in the consolidated financial statements of the Port Sudan Group for the year ended 31 December 20X2. (10 marks)

(ii) Adjust the prepopulated spreadsheet response option to correct the draft consolidated statement of financial position of the Port Sudan Group as at 31 December 20X2. (10 marks)

(c) Using exhibit 3, discuss the potential impact of the changes in government regulation on the accounting treatment of Atbara Co in the consolidated financial statements for the year ended 31 December 20X3. (5 marks)

(Total 30 marks)

Question (2)

Background information

Abasi Co is a new company formed on 1 January 20X7. The company's financial year end is 31 December 20X7.

The following exhibits, available below, provide information relevant to the question:

1 Receipt and crowd-funding – describes the receipt of cash from Pain a director information regarding a crowd-funding campaign.

2 Ethical issues – describes Mr Mavic's actions regarding the crowd-funding campaign and subsequent manufacture of Zolo drones.

This information should be used to answer the question requirements.

1 – Receipt and crowd-funding

As Abasi Co is a new company, Mr. Mavic (a qualified accountant) occupies the roles of both finance director and production director. There is also a technical director, Mr Pain (inventor of the Zolo drones. The share capital of Abasi Co comprises 10 $1 shares held equally by the two directors, Mr Mavic and Mr Pain.

On 31 March 20X7, Abasi Co received $0.5 million from Mr Pain (technical director) to assist the company in developing the Zolo drone. There was no specified repayment date, although Mr Pain can demand repayment of the $0.5 million at any time.

On the same date, Abasi Co started a crowd-funding campaign on the Crowd-People platform to raise additional funds to develop the Zolo drone. The campaign was aimed at raising small amounts of money from a large number of contributors. The crowd-funding campaign, which ended on 30 April 20X7, raised $2.4 million. Each contributor donated $300 to the campaign and, in exchange, was promised a drone once production was complete.

There were production delays. Although Abasi Co had manufactured some drones, none had been shipped to crowd-funding contributors by 31 December 20X7. All money spent on research and development activities has been correctly recognised in accordance with IAS 38 Intangible Assets. In addition, by the year end, the total cost incurred on manufacturing drones for the crowd-funding contributors was $1.5 million.

2 – **Ethical issues**

On 31 March 20X7, Abasi Co released an advertising video for the Zolo drone on the Crowd-People platform.

In order to boost this crowd-funding campaign, the Zolo drone was also advertised at a trade show on 2 April 20X7. The functionality of the drone at the trade show was significantly poorer than the functionality demonstrated in the video. Mr Mavic knew that the Crowd-funding advertising video was misleading about the capabilities of the Zolo drone.

During the crowd-funding campaign, Mr Mavic believed that the company would be able to develop and produce the number of drones required by the promised delivery date of 30 September 20X7. He now realises that the video was also misleading about the readiness of the drone.

On 1 May 20X7, Mr Mavic ordered a significant amount of component parts to be used in the manufacture of the Zolo drone to fulfill the crowd-funding promise to the contributors. He realised also that the success of the crowd-funding campaign would cause enormous difficulties for the company as they did not have the capability to manufacture and deliver the Zolo drone in line with their promises. In spite of this, he awarded himself a salary at the current market rate and also leased an executive car for himself. The Crowd-People platform allows any user to report any projects which were felt to be misleading, however only one person did so.

Mr Mavic regularly communicated with the contributors but the communications, although honest, reflected a lack of awareness of the problems which the company was facing. No cash budget was ever created for the project. On 30 September 20X7, although the cost of producing a Zolo drone had increased by 300%, he still felt that these increasing costs would be covered by the monies raised from crowd-funding and the money received from Mr Pain.

In December 20X7, Abasi Co sent 500 Zolo drones to new customers as opposed to sending them as promised to the crowd-funding contributors. The new customers represented additional revenue. It was known that these drones were not fully functional. A significant number of these sales to new customers were refunded due to quality issues.

Required:

(a) Using exhibit 1 only, discuss how the 0,5 million receipt form Mr pain and the crowd-funding should be treated in the financial statements in the year ended 31 December 2007 10 marks

(b) Using exhibit 2 discuss how ethical issue raised by Mr Mavic ,s regarding the crowd-funding campaign and subsequent manufacture of Zolo drones. 10 marks

(Total: 20 marks)

Section (2)
Answer Two Questions from Those Three Questions

Question1;
Background
Wing Co manufactures textile products and is currently assessing the impact of a global pandemic on its operations. The financial year end of the company is 31 December 20X8.
The following exhibit, available below, provides information relevant to the question:
1 Impact of pandemic – describes the impact of the pandemic on certain aspects of Wing Co's business.
This information should be used to answer the question requirements.
Exhibit 1 – Impact of pandemic
There are several measures taken by government and banks in the jurisdiction which Wing Co operates in order to provide relief for companies which have been negatively affected by the pandemic. The business reduction loan scheme provides lenders with a government guarantee of 90% on each loan to give lenders confidence in continuing to provide finance to companies. The national bank is also buying short-term debt from companies.
Wing Co has a history of profitable operations and relies on external financing resources.
Wing Co has taken advantage of the government support measures. However, its operations have been temporarily suspended before and after the reporting date of 31 December 20X8.
The impact of the pandemic has created circumstances which change rapidly.
The pandemic has significantly affected the global supply chain. Wing Co has several contracts to sell goods at a fixed price. The government requires a shutdown of Wing's manufacturing facilities, meaning that Wing cannot deliver the goods itself without first buying them from a third party at a significantly higher cost. Normally if Wing Co terminates the contracts, then it incurs a penalty. Exceptionally, some contracts can be cancelled without paying compensation.
Wing Co has several investment properties which it measures at fair value in accordance with IFRS 13 Fair Value Measurement. The pandemic has significantly affected the market price of these properties.
The directors of Wing Co are of the opinion that the market is undervaluing its properties and have therefore decided to disregard market prices at 31 December 20X8. The directors claim that some of the market transactions are not representative as they are based on transactions which are forced due to the cash flow problems of the vendors. The directors have indicated that they would not sell their properties in the current market. There has been a significant decrease in the volume of transactions in the property market. However, several properties, similar to those held by Wing Co, have been sold in December 20X8.

Required:
(a) With regards to Wing Co's financial statements for the year ended 31 December 20X8, discuss the impact that the pandemic and subsequent events will have on:
(i) The assessment regarding Wing Co's ability to remain a 'going concern' (5 marks)
(ii) Accounting for onerous contracts, and (4 marks)
(iii) Fair value measurement of investment property. (6 marks)

(c) Discuss the nature of the information that investors of Wing Co will expect to be disclosed in financial statements as a result of the pandemic. Candidates should include, amongst other things, such factors as:

1 -Disclosure of uncertainties,
2 -Events after the reporting period,
3 -Government measures and covenants.

(10marks)

(Total: 25 marks)

Question2;

(1) On1 December 20X1, Bristow provides a service to a customer for the next 12 month . The consideration is $ 12 million Bristow is entitled to an extra $ 3 million if, after twelve month , the number of the mistakes made falls below certain threshold.

Required:

Discuss the accounting treatment of above in Bristow's financial statements for the year ended **31** December20X1 if :

(a) Bristow has experience of providing identical service in the past and it is highly probable that the number of mistakes made will fall below the acceptable threshold. (7.5marks)

(b)Bristow has have no experience of providing this service and is unsure number of the mistakes made will fall below threshold. (7.5marks)

(Total: 15 marks)

(2)Under new legislation, an entity is required to fit smoke filters to its factories by 31 31 December20X7.

At the reporting date of 30 June 20X7 the entity has not fitted the smoke filters.

Required:

Should a provision be made at the reporting data for estimated coast of fitting the fitter.(10 marks)

(Total: 25 marks)

Question3;

(1) Coaster wishes to purchase a new ride for its 'Animation Galaxy Theme Park but require extra funding. On 30 September 20x3 coaster issued the following preference shares:

- 1 million preference shares for $ 3 each. No dividends are payable, coasters will redeem the preference shares in three years s time by issuing ordinary shares issuable will be based on their fair value on 30 September 20x6.

- 2 million preference shares for $ 2.80 each. No dividend are payable preference shares will be redeemed in two year's time by basing 3 million ordinary shares.

- 4 million preference shares for $ 2.50 each. They are not mandatorily redeemable. A dividend is payable preference if dividends are paid on ordinary shares.

- **Required:**

Discuss whether these financial instruments should be classified as financial liabilities or equity in the financial statement of coasters for the years ended 30 September20x3. (15 marks)

(2) An entity. Dodge owns property, plant and equipment that cost $ 100, 000 when purchased . Depreciation of $ 40.000 has been charged up to the reporting date of 31 March 20X1 . The entity has claimed total tax allowances on the asset of $ 50.000 . On 31 March 20x1 . the asset is revalued to $ 90.000 , The tax rate is 30%

Required:

Explain the deferred tax implications of this situation

(10 marks)

(Total: 25 marks)