

ACCA Paper

F7

Financial Reporting



Please spread the word about
OpenTuition, so that all ACCA
students can benefit.

Visit opentuition.com for the latest updates - watch
the free lectures that accompany these notes;
attempt free tests online;
get free tutor support, and much more.

**The best things
in life are free**

IMPORTANT!!! PLEASE READ CAREFULLY

To benefit from these notes you **must** watch the free lectures on the OpenTuition website in which we explain and expand on the topics covered

In addition question practice is vital!!

You **must** obtain a current edition of a Revision / Exam Kit from one of the ACCA approved content providers. They contain a great number of exam standard questions (and answers) to practice on.

You should also use the free "Online Multiple Choice Tests" and the "Flashcards" which you can find on the OpenTuition website.

<http://opentuition.com/acca/>

CONTENTS

1	Financial Reporting – basic concepts	1
2	The regulatory framework	3
3	Published Financial Statements	7
4	IFRS5 – Discontinued operations and assets held for sale	17
5	IAS 8	21
6	Group Accounts: An Introduction	25
7	Preparation of the Consolidated Statement of Financial Position	31
8	Group Accounts: Inter-entity Transactions	45
9	Group Accounts: Comprehensive Example	55
10	Preparation of the Consolidated Statement of Profit or Loss and Other Comprehensive Income	57
11	Accounting for Investments in Associates (IFRS3 Revised)	63
12	IAS 2 Inventories	67
13	Calculation of Construction Contract Profits	69
14	IAS 36 Impairment of Assets	77
15	IAS 37 Provisions, Contingent Liabilities and Contingent Assets	81
16	IFRS 16 Leases	87
17	IAS 23 Borrowing Costs	91
18	IAS 12 Income Taxes	93
19	IAS 7 (Revised): Statements of Cash Flows	99
20	Interpretation of Accounts – Ratio Analysis	109
21	IAS 33 Earnings Per Share	115
22	Theoretical matters	123
23	IAS 16 Property, Plant and Equipment	127
24	IFRS 15 Revenue from contracts with customers	129
25	IAS 20 Government Grants	135
26	IAS 38 Intangible Assets	137
27	IAS 40 Investment Properties	139
28	IFRS 9 Financial Instruments	141
29	Agriculture	147
30	The Effects of Changes in Foreign Exchange Rates	151
31	Answers to Examples	155
32	Mini Exercises – Questions	197
33	Mini Exercises – Answers	225

Visit [OpenTuition.com](https://www.opentuition.com) and use our FREE Online Multiple Choice Tests

OpenTuition Lecture Notes can be downloaded **FREE** from [OpenTuition.com](https://www.opentuition.com)

Copyright belongs to [OpenTuition.com](https://www.opentuition.com) - please do not support piracy by downloading from other websites.





Chapter 1

 Free lectures available for Paper F7 - [click here](#)**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



Chapter 2

 **Free lectures available for Paper F7 - [click here](#)**

THE REGULATORY FRAMEWORK

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



Chapter 2 The regulatory framework

Framework – qualitative characteristics

- understandable D12, D13
- comparable pilot, J08, D12, D13
- relevant pilot, D13
- faithful representation D07, D13
- complete D13
- material J08, D13
- substance over form J08, J10
- reliable pilot, D07
- neutral D13
- provable J08, D13

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

Fundamental characteristics

(Relevant, and faithful representation)

- *completeness*
- *neutrality, and*
- *material accuracy*

Enhancing characteristics

(Reliability)

- *understandability*
- *verifiability*
- *comparability, and*
- *timeliness*



Financial statements comprise:

- Statement of financial position
- Statement of profit or loss and other 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)

WHEN YOU FINISHED THIS CHAPTER YOU SHOULD ATTEMPT THE [ONLINE F7 MCQ TEST](#)



Chapter 3

 Free lectures available for Paper F7 - [click here](#)

PUBLISHED FINANCIAL STATEMENTS

- proforma financial statements following IAS1 (revised)

XYZ GROUP

Statement of Profit or Loss and Other Comprehensive Income for the year ended 31 December, 2009

(classification of expenses by function)

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

XYZ GROUP

Statement of Profit or Loss and Other Comprehensive Income for the year ended 31 December, 2009

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



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

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



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 Changes in Equity for the year ended 31 December, 2009

	<i>Share capital</i>	<i>Share premium</i>	<i>Revaluation reserve</i>	<i>Retained earnings</i>	<i>Non-controlling interest</i>	<i>Total</i>
	<i>\$000</i>	<i>\$000</i>	<i>\$000</i>	<i>\$000</i>	<i>\$000</i>	<i>\$000</i>
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
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)
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	<u>X</u>	<u>X</u>	<u>X</u>	<u>X</u>	<u>X</u>	<u>X</u>



- 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**

- 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
	<hr/>
	X
Average weekly number of persons employed during the year:	
Full time	X
Part time	X
	<hr/>
	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
	<hr/>
	X
	<hr/>
	X

• **income tax expense**

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

• **dividends**

Ordinary		
- interim	4.15c paid	X
- final	7.85c proposed	X
		<hr/>
		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

	<i>Deferred Development Expenditure</i>	<i>Goodwill</i>	<i>Total</i>
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	<u>X</u>	<u>X</u>	<u>X</u>

At 31 December, 2009

Cost	X	X	X
Accumulated amortisation/impairment losses	(X)	(X)	(X)
Net book value	<u>X</u>	<u>X</u>	<u>X</u>

At 1 January, 2009

Cost	X	X	X
Accumulated amortisation/impairment losses	(X)	(X)	(X)
Net book value	<u>X</u>	<u>X</u>	<u>X</u>

- **property, plant and equipment**

	<i>Land and buildings</i>	<i>Machinery</i>	<i>Office equipment</i>	<i>Total</i>
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	<u>X</u>	<u>X</u>	<u>X</u>	<u>X</u>

At 31 December, 2009

Cost or valuation	X	X	X	X
Accumulated depreciation/impairment losses	(X)	(X)	(X)	(X)
Net book value	<u>X</u>	<u>X</u>	<u>X</u>	<u>X</u>

At 1 January, 2009

Cost or valuation	X	X	X	X
Accumulated depreciation/impairment losses	(X)	(X)	(X)	(X)
Net book value	<u>X</u>	<u>X</u>	<u>X</u>	<u>X</u>

- 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)**

	<i>Fair Value Model</i>	<i>Cost Model</i>
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	<u>X</u>	<u>X</u>
At 31 December, 2009		
Gross carrying amount		X
Accumulated depreciation/ impairment losses		(X)
Net book value		<u>X</u>
At 1 January, 2009		
Gross carrying amount		X
Accumulated depreciation/ impairment losses		(X)
Net book value		<u>X</u>

• **inventories (IAS 2 revised)**

Merchandise	X
Production supplies	X
Materials	X
Work in progress	X
Finished goods	<u>X</u>
	<u>X</u>

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	<u>X</u>
	<u>X</u>

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	<u>X</u>
	<u>X</u>

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**

	<i>Number of shares</i>	<i>Equity shares</i>	<i>Share premium</i>	<i>Total</i>
		<i>\$'000</i>	<i>\$'000</i>	<i>\$'000</i>
At 1 January, 2009	X	X	X	X
Issue of shares	<u>X</u>	<u>X</u>	<u>X</u>	<u>X</u>
At 31 December, 2009	<u>X</u>	<u>X</u>	<u>X</u>	<u>X</u>

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	<u>X</u>
	<u>X</u>

• **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	<u>X</u>
	<u>X</u>

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	<u>(X)</u>
Provision carried forward at 31 December, 2009	<u>X</u>

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.

WHEN YOU FINISHED THIS CHAPTER YOU SHOULD ATTEMPT THE [ONLINE F7 MCQ TEST](#)



Chapter 4

 **Free lectures available for Paper F7 - [click here](#)**

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 Profit or Loss and Other 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 Profit or Loss and Other 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	<u>(39)</u>
Operating cashflows	(X)
Investing cashfows	X
Financing cashflows	(X)
	<u>X</u>
The assets and liabilities disposed of were as follows:	
Property, plant and equipment	X
Current assets	X
Total assets	<u>X</u>
Total liabilities	<u>(X)</u>
Loss on disposal before tax	(X)
Tax charge thereon	X
	<u>(X)</u>



Chapter 5

 **Free lectures available for Paper F7 - [click here](#)**

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 Profit or Loss and Other 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 Profit or Loss and Other Comprehensive Income extract and summarised Statement of Financial Position for the year ended 31 December, 2008

	<i>\$'000</i>
Revenue	2,500
Cost of sales and expenses	<u>(1,200)</u>
Profit for the year	<u><u>1,300</u></u>

Statement of Financial Position at 31 December, 2008

Non-current assets	2,000
Current assets	<u>800</u>
	<u><u>2,800</u></u>
Share capital	600
Reserves	<u>2,000</u>
	2,600
Current liabilities	<u>200</u>
	<u><u>2,800</u></u>

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 Profit or Loss and Other Comprehensive Income extract for the year ended 31 December, 2009

	<i>\$'000</i>
Revenue	2,600
Costs and expenses	<u>(1,400)</u>
Profit for the year	<u><u>1,200</u></u>

Statement of Financial Position at 31 December, 2009

Non-current assets	2,800
Current assets	<u>1,700</u>
	<u><u>4,500</u></u>
Share capital	600
Retained earnings	<u>3,500</u>
	4,100
Current liabilities	<u>400</u>
	<u><u>4,500</u></u>

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

WHEN YOU FINISHED THIS CHAPTER YOU SHOULD ATTEMPT THE [ONLINE F7 MCQ TEST](#)



Chapter 6

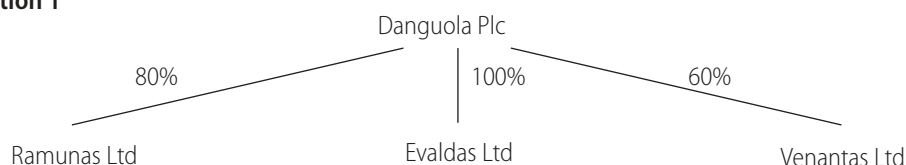
 Free lectures available for Paper F7 - [click here](#)

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 that the sole trader's assets would generate are now under the entity's control and reported in its Statement of Profit or Loss and Other 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:

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

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

OpenTuition.com

Parent entity Statement of Financial Position

- under IFRS3 (Business Combinations), 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



OpenTuition.com

• **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:

	<i>Vytautas</i> \$	<i>Gediminas</i> \$
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		
\$1 Equity shares	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



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
	<u>97,000</u>
 EQUITY AND LIABILITIES	
\$1 Equity shares	40,000
Retained earnings	32,000
	<u>72,000</u>
Current liabilities	25,000
	<u>97,000</u>

- 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 $(9,600 - 2,600) \times 100\%$



Definition of a subsidiary

- 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.



WHEN YOU FINISHED THIS CHAPTER YOU SHOULD ATTEMPT THE [ONLINE F7 MCQ TEST](#)



Chapter 7

 **Free lectures available for Paper F7 - click here**

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 Separate Financial Statements, 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:

	<i>Rasa</i> \$	<i>Tatjana</i> \$
Investment in Tatjana	18,000	-
Other assets	30,000	20,000
	<u>48,000</u>	<u>20,000</u>
\$1 Equity shares	20,000	8,000
Retained earnings	22,000	10,000
	42,000	18,000
Liabilities	6,000	2,000
	<u>48,000</u>	<u>20,000</u>

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:

	<i>Rasa</i>	<i>Tatjana</i>
	\$	\$
Investment in Tatjana	18,000	
Other assets	40,000	26,000
	<u>58,000</u>	<u>26,000</u>
\$1 Equity shares	20,000	8,000
Retained earnings	31,000	14,000
	51,000	22,000
Liabilities	7,000	4,000
	<u>58,000</u>	<u>26,000</u>

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	<u>23,000</u>
\$1 Equity shares	12,000
Retained earnings	<u>8,000</u>
	20,000
Liabilities	<u>3,000</u>
	<u>23,000</u>

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

	<i>Aurimas</i>	<i>Oleg</i>
	\$	\$
Investment in Oleg	20,000	-
Other assets	40,000	30,000
	<u>60,000</u>	<u>30,000</u>
\$1 Equity shares	10,000	12,000
Retained earnings	42,000	15,000
	52,000	27,000
Liabilities	8,000	3,000
	<u>60,000</u>	<u>30,000</u>

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

Area reserved for the preparation of 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 Profit or Loss and Other 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:

	<i>Maruta</i>	<i>Liene</i>
	\$	\$
Investment in Liene	30,000	-
Other assets	40,000	27,000
	<u>70,000</u>	<u>27,000</u>
\$1 Equity shares	25,000	15,000
Retained earnings	36,000	5,000
	61,000	20,000
Liabilities	9,000	7,000
	<u>70,000</u>	<u>27,000</u>

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		<u>X</u>
		X
Net assets @ doa		
\$1 Equity shares	X	
Retained earnings	<u>X</u>	
		<u>X</u>
Goodwill		X
Impaired since acquisition		<u>(X)</u>
Therefore, on CSoFP		<u><u>(X)</u></u>

• **(W3) Consolidated retained earnings**

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

• **(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		<u>X</u>
		X
Less: their share of goodwill impairment		<u>(X)</u>
Nci on CSoFP		<u><u>X</u></u>



Chapter 7

Preparation of the Consolidated Statement of Financial Position

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 on a full or fair value basis
- the key is the use of the word “proportional” or “proportion” or “proportionate”

EXAMPLE 5

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:

	<i>Remigijus</i>	<i>Ilona</i>
	\$	\$
Investment in Ilona	80,000	-
Other assets	100,000	150,000
	<u>180,000</u>	<u>150,000</u>
\$1 Equity shares	50,000	32,000
Retained earnings	90,000	98,000
	140,000	130,000
Liabilities	40,000	20,000
	<u>180,000</u>	<u>150,000</u>

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 a full or fair value basis of the market value of the subsidiary information may be given in any one of three 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 6

Ivona bought 60% of the shares of Guido for \$100,000 when the Guido retained earnings were \$40,000. The Ivona directors have valued the goodwill attributable to the nci at \$5,000. Goodwill has not been impaired since acquisition. At 30 June, 2010, the respective Statements of Financial Position were:

	<i>Ivona</i>	<i>Guido</i>
	\$	\$
Investment in Guido	100,000	-
Other net assets	60,000	190,000
	<u>160,000</u>	<u>190,000</u>
\$1 Equity shares	70,000	80,000
Retained earnings	90,000	110,000
	<u>160,000</u>	<u>190,000</u>

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.

OpenTuition.com

- 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

Free ACCA notes • Free ACCA lectures • Free ACCA tests • Free tutor support • StudyBuddies • ACCA forums  OpenTuition.com

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.

	<i>Robertas</i>		<i>Ingrida</i>	
	\$	\$	\$	\$
Investment in Ingrida		15,000		-
TNCA		12,000		30,000
Other assets		13,000		4,000
		<u>40,000</u>		<u>34,000</u>
\$1 Equity shares		5,000		3,000
Share premium		-		1,500
Retained earnings at 1 January, 2009	24,000		20,000	
Profit for 2009	<u>10,000</u>		<u>6,000</u>	
		<u>34,000</u>		<u>26,000</u>
		39,000		30,500
Liabilities		1,000		3,500
		<u>40,000</u>		<u>34,000</u>

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.



Chapter 8

 **Free lectures available for Paper F7 - [click here](#)**

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:

	<i>Jurate</i>	<i>Dovile</i>
	<i>\$'000</i>	<i>\$'000</i>
NON-CURRENT ASSETS		
Tangible	400	150
Investment in Dovile	<u>140</u>	<u>150</u>
	540	150
CURRENT ASSETS		
Inventory	70	50
Receivables – Dovile	90	-
– other	80	70
Cash	<u>30</u>	<u>20</u>
	270	140
Total assets	<u><u>810</u></u>	<u><u>290</u></u>
EQUITY		
\$1 Equity shares	500	200
Retained earnings	<u>200</u>	<u>30</u>
	700	230
CURRENT LIABILITIES		
Trade payables – other	110	10
– Jurate	<u>-</u>	<u>50</u>
	110	60
Total equity and liabilities	<u><u>810</u></u>	<u><u>290</u></u>

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:

	<i>Jurate</i> \$'000	<i>Dovile</i> \$'000
NON-CURRENT ASSETS		
Tangible	400	150
Investment in Dovile	<u>140</u>	<u> </u>
	540	150
CURRENT ASSETS		
Inventory	70	50 + 10
Receivables - Dovile	90 - 30	-
- other	80	70
Cash	<u>30 + 30</u>	<u>20</u>
	270	150
Total assets	<u>810</u>	<u>300</u>
EQUITY		
\$1 Equity shares	500	200
Retained earnings	<u>200</u>	<u>30</u>
	700	230
CURRENT LIABILITIES		
Trade payables - other	110	10
- Jurate	<u> </u>	<u>50 + 10</u>
	110	70
Total equity and liabilities	<u>810</u>	<u>300</u>

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:

- $$\text{Cost} + \text{Profit} = \text{SP}$$

- 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

$$\begin{array}{rcccc} \text{C} & + & \text{Profit} & = & \text{SP} \\ ? & + & 20 & = & 100 \end{array}$$

therefore cost must be 80



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 also be made in the records of the selling entity.

- method**

make the adjustments **ON THE FACE OF THE QUESTION:**

- Dr Retained earnings
 Cr Non-current assets
with the provision for unrealised profit in the financial statements of the entity selling the asset.
- Dr Non-current assets
 Cr Retained earnings
with the surplus depreciation also in the financial statements of the entity selling 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:

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

Note:

- During the year ended 31 December, 2009 Linas sold a piece of plant and equipment to Asta for \$90,000. 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.
- 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 against 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.



- and finally one last problem
- the examiner has introduced one last difficulty and it arises with frequent regularity
- it's a problem relating to the cost of acquisition by the parent of the investment in the subsidiary
- so far, we have considered only a cash payment made by the parent to the former shareholders of the subsidiary so the parent could buy those shares
- but what if, instead of or as well as offering cash, the parent issued some of its own shares in exchange for the shares in the subsidiary
- say you hold 500 shares in an entity and you have just received an offer from another entity wanting to buy your 500 shares
- but instead of offering you cash today, they make an alternative suggestion
- the alternative could for example be a combination of different elements such as:-
 - cash next year
 - a loan note (a promise by this new company to pay you sometime in the future)
 - some shares in their own company

ILLUSTRATION

Here are the relevant extracts from question 1 in the December 2012 examination:-

Viagem acquired 90% of the equity share capital of Greca on 1 January, 2012 in a share for share exchange in which Viagem issued two new shares for every three shares it acquired in Greca.

In addition, on 31 December, 2012 Viagem will pay the shareholders of Greca \$1.76 per share acquired.

Viagem's cost of capital is 10% per annum

- at the date of acquisition, shares in Viagem and Greca had a stock market value of \$6.50 and \$2.50 each, respectively
- the fair value of the non-controlling interest investment is the fair value of the shares held by them
- we are also told that the \$1 equity shares and the retained earnings of the two companies as at 1 January, 2012 were:

	Viagem	Greca
\$1 equity shares	30,000	10,000
Retained earnings	54,000	35,000

Solution

How many shares did we acquire?

$$90\% \times 10,000 = 9,000$$

How many shares did we issue?

we issued two new shares for every three acquired so:

$$9,000/3 \times 2 \text{ means we issued } 6,000 \text{ of our own shares to acquire } 9,000 \text{ shares in Greca}$$

And how much were our shares worth?

\$6.50

therefore, the value of the shares we issued to acquire 90% of Greca was

6,000 × \$1 nominal value of share capital	6,000
6,000 × \$5.50 share premium	33,000

OK, that's the share for share element sorted out



Now for the deferred cash payment, payable on 31 December 2012

At a cost of capital of 10% an amount of \$1.10 payable in one year's time has a present value of $\$1.10 \times \frac{1}{1.10} = \1

So an amount of \$1.76 has a "today" value of $\$1.76 \times \frac{1}{1.10}$ ie \$1.60

and 9,000 shares acquired $\times \$1.60 = \$14,400$

therefore total consideration for the acquisition is:

\$1 equity shares	6,000
share premium	33,000
deferred cash payment	14,400

add to that the nci investment value of 1,000 shares valued at \$2.50 = \$2,500

total value of Greca is therefore \$55,900

- for more practice with share for share exchanges, try the mini-exercises at the end of these notes

WHEN YOU FINISHED THIS CHAPTER YOU SHOULD ATTEMPT THE [ONLINE F7 MCQ TEST](#)



Chapter 9

 Free lectures available for Paper F7 - [click here](#)

GROUP ACCOUNTS: COMPREHENSIVE EXAMPLE

EXAMPLE 1

When Ausra bought 75% of the Danute 50c equity shares of 31 March, 2011, the value of the Ausra \$1 equity shares was \$4.30 and the Danute shares had a market value of \$2.20.

The terms of the acquisition were a combination of elements:

- for every 3 shares acquired Ausra issued 1 new share
- a payment of \$1.21 for each 2 shares acquired payable on 1 April 2013
- a payment of \$0.60 per share acquired immediately

The Ausra cost of capital is 10% per annum

Only the cash payment on 31 March 2011 has so far been recorded

On 31 October 2011, the respective Statements of Financial Position were:

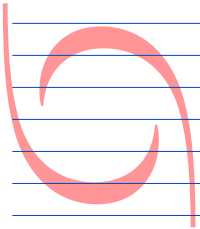
	<i>Ausra</i>	<i>Danute</i>
	\$	\$
Investment in Danute	36,000	–
TNCA	260,000	200,000
Inventory	100,000	50,000
Receivables	90,000	80,000
Cash	<u>5,000</u>	<u>36,000</u>
Total assets	<u>491,000</u>	<u>366,000</u>
\$1 Equity shares (50c Danute)	100,000	40,000
Share premium	30,000	20,000
Retained earnings	<u>215,000</u>	<u>124,000</u>
	345,000	184,000
Long term liabilities		
3% Debentures	<u>30,000</u>	<u>80,000</u>
	375,000	264,000
Current liabilities	<u>116,000</u>	<u>102,000</u>
	<u>491,000</u>	<u>366,000</u>

1. At the date of acquisition, some of Danute's inventory had a fair value \$12,000 in excess of its carrying value. All of this inventory had been sold before the year end.
2. On 31 July 2011, Danute had sold an item of property, plant and equipment to Ausra realising a profit on sale of \$36,000. Ausra 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 1 October, 2011 Ausra had despatched goods to Danute at a transfer value of \$26,000. Ausra sells goods at a margin of 30%. Danute 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 Danute had sent a payment of \$6,500 to Ausra, but Ausra only received it on 2 November 2011. Before any necessary adjustment, the intra group balance in Danute's records showed an amount owing to Ausra of \$11,500.
5. Goodwill is impaired by 25%.
6. Profits for the two companies for the year to 31 October, 2011 (before any adjustments necessary to be made) were respectively \$70,000 and \$60,000
7. Both entities have declared but not yet accounted for a dividend per share of 10c (Ausra) and 3c (Danute).
8. The directors valued the nci investment on a fair value basis using the market value of the Danute shares as a fair measure.

Prepare a Consolidated Statement of Financial Position for the Ausra Group as at 31 October 2011.



OpenTuition.com



Chapter 10

 Free lectures available for Paper F7 - [click here](#)

PREPARATION OF THE CONSOLIDATED STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME

Purpose

aim

- the aim of the Consolidated Statement of Profit or Loss and Other 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 Profit or Loss and Other 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:

	<i>Mantas</i>	<i>Rochas</i>
	\$	\$
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	<u>12,000</u>	<u>3,500</u>

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

Prepare the Consolidated Statement of Profit or Loss and Other Comprehensive Income of Mantas Group for the year ended 31 December, 2009.

Free ACCA notes • Free ACCA lectures • Free ACCA tests • Free tutor support • StudyBuddies • ACCA forums  **OpenTuition.com**



Preparation of the Consolidated Statement of Profit or Loss and Other Comprehensive Income

(Ignore goodwill)

Strictly speaking, the Statement of Profit or Loss and Other 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 Profit or Loss and Other 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:

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

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 Profit or Loss and Other 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:

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

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 Profit or Loss and Other 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:

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

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 Profit or Loss and Other 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:

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

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 Profit or Loss and Other 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 Profit or Loss and Other 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:

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

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 Profit or Loss and Other Comprehensive Income for the Lasma Group for the year ended 31 August 2009

Disposal of subsidiary

- Within the ACCA F7 syllabus is the topic "Explain and illustrate the effect of the disposal of a parent's investment in a subsidiary in the parent's individual financial statements and/or those of the group (restricted to disposals of the parent's entire investment in the subsidiary)"

Disposal of investment

- there are a number of different situations which could arise but the F7 syllabus is restricted to just one, namely where the parent's entire investment is disposed
- where a parent sells its entire holding in a subsidiary, we require two workings to calculate the gain (or loss) on disposal in both the parent's own financial statements (W3A) and the group's financial statements (W3B)

W3A Gain in parent

proceeds of disposal	X
less carrying value sold	(X)
gain in parent	<u><u>X</u></u>

This gain, in an exam, may be taxable - the examiner will tell you.

Continuing the working:

gain in parent from above	X
tax at, say, 25%	(X)
net gain in parent	<u><u>X</u></u>



W3B Gain in group

proceeds of disposal			X
NA @ DOD			
Equity shares		X	
retained earnings		X	
		<u>X</u>	
% sold	say	80%	(X)
			<u>X</u>
goodwill sold			(X)
gain in group			X
tax (the same figure as in W3A)			(X)
net gain in group			<u>X</u>

EXAMPLE 7

Diana had acquired 75% of Liga's 300,000 \$1 equity shares four years ago when Liga's retained earnings were \$150,000. On 30 June, 2009 Diana sold the entire holding for \$400,000.

NCI investment on acquisition was valued on a proportional basis.

There had been no impairment of goodwill up to 30 June, 2009

The disposal has not yet been reflected in Diana's financial statements. Taxation rate for entities is 30%

The following are the summarised financial statements for Diana and Liga for 30 June, 2016.

	<i>Diana</i>	<i>Liga</i>
Investment in Liga	350,000	
Other net assets	750,000	700,000
	<u>1,100,000</u>	<u>700,000</u>
\$1 Equity shares	500,000	300,000
Retained earnings	600,000	400,000
	<u>1,100,000</u>	<u>700,000</u>
Profit before tax	100,000	70,000
Tax	30,000	21,000
Retained earnings for the year	<u>70,000</u>	<u>49,000</u>

Prepare the consolidated financial statements for the Diana Group for 30 June, 2009

Chapter 11

 **Free lectures available for Paper F7 - [click here](#)**

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 $\geq 20\%$ but $\leq 50\%$ 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 Profit or Loss and Other 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	<u>X</u>

- Statement of Profit or Loss and Other 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 Profit or Loss and Other Comprehensive Income. It does not matter whether the goods were bought from, or sold to, the associate. ALWAYS in the associate's records.
 - 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:

	<i>Laura Group</i> \$'000	<i>Gunta</i> \$'000
Investment in Gunta	4	
Other assets	180	23
	<u>184</u>	<u>23</u>
\$1 Equity shares	70	2
Retained earnings	99	18
	169	20
Liabilities	15	3
	<u>184</u>	<u>23</u>

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



Chapter 12

 **Free lectures available for Paper F7 - [click here](#)**

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

 **Free lectures available for Paper F7 - [click here](#)**

CALCULATION OF CONSTRUCTION CONTRACT PROFITS

OpenTuition.com

- 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 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 Profit or Loss and Other 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	<u><u>X</u></u>

• **W2 Statement of financial position**

• Costs to date	X
Attributable profits (W1)	X
	<u>X</u>
Less amount invoiced	(X)
Amounts due from customers	<u><u>X</u></u>

• **W3 Statement of financial position**

Amounts invoiced	X
Less amounts received	(X)
Amounts due from customers	<u><u>X</u></u>

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 Profit or Loss and Other Comprehensive Income and Statement of Financial Position.





Chapter 14

 Free lectures available for Paper F7 - [click here](#)

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

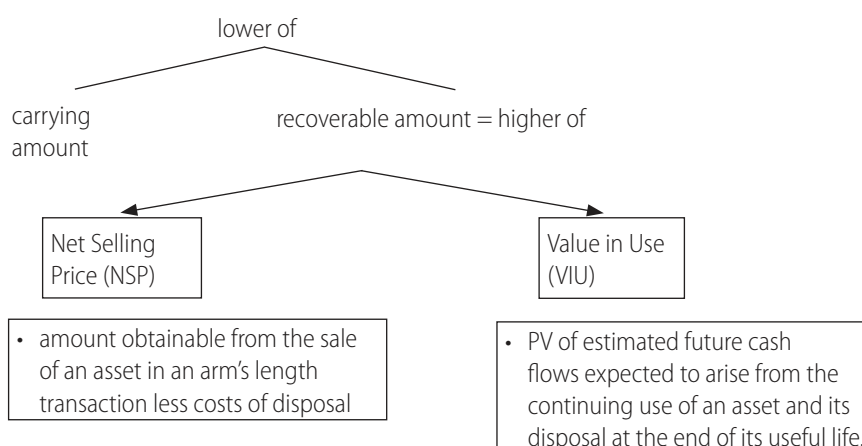
- **external indicators may include:**

- 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 Profit or Loss and Other 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 Profit or Loss and Other 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 viú or nsp, together with details of discount rate or selling price as appropriate

WHEN YOU FINISHED THIS CHAPTER YOU SHOULD ATTEMPT THE [ONLINE F7 MCQ TEST](#)





Chapter 15

 **Free lectures available for Paper F7 - [click here](#)**

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

Free ACCA notes • Free ACCA lectures • Free ACCA tests • Free tutor support • StudyBuddies • ACCA forums



- 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

<i>Probability of outcome</i>	<i>Assets</i>	<i>Liabilities</i>
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.



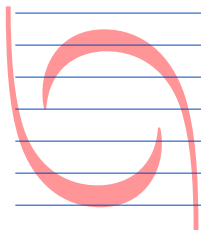
EXAMPLE 4

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

OpenTuition.com



WHEN YOU FINISHED THIS CHAPTER YOU SHOULD ATTEMPT THE [ONLINE F7 MCQ TEST](#)



Chapter 16

 **Free lectures available for Paper F7 - [click here](#)**

IFRS 16 LEASES

- the classic example of “substance over form”
- definitions
 - 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 plus any initial direct costs of the lessor
 - 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 lease term also includes periods covered by a termination option if the lessee is reasonably certain not to exercise that option
 - lessee’s incremental borrowing rate
 - the rate of interest that a lessee would have to pay to borrow over a similar term, and with a similar security, the funds necessary to obtain an asset of a similar value to the right-of-use asset in a similar economic environment
- objective
 - establishes principles for the recognition, measurement, presentation and disclosure of leases, with the objective of ensuring that lessees and lessors provide relevant information that faithfully represents those transactions
- scope
 - applies to all leases, including subleases, with few exceptions where the issue is dealt with by other IFRS / IAS eg IAS 41 Agriculture
- recognition exemptions
 - instead of applying the recognition requirements of IFRS 16 described below, a lessee may elect to account for lease payments as an expense on a straight-line basis over the lease term or another systematic basis for the following two types of leases:
 - leases with a lease term of 12 months or less and containing no purchase options – this election is made by class of underlying asset
 - leases where the underlying asset has a low value when new (such as personal computers or small items of office furniture) – this election can be made on a lease-by-lease basis



- identifying a lease
 - a contract is, or contains, a lease if it involves the right to control the use of an identified asset for a period of time in exchange for consideration
 - a right to control is where the customer has both the right to direct the identified asset's use and to obtain substantially all the economic benefits from that use
 - an asset is typically identified by being explicitly specified in a contract, but an asset may instead be identified by implication when it is made available for the customer's use by the supplier
 - however, where a supplier has a substantive right of substitution throughout the period of use, a customer does not have a right to use an identified asset
 - a supplier's right of substitution is only considered substantive if the supplier has both the practical ability to substitute alternative assets throughout the period of use and there would be economic benefit from substitution for the supplier
 - a lease of only part of the capacity of an asset is still an identified asset if it is physically distinct (e.g. a floor of a building)
 - a leased portion of an asset that is not physically distinct (e.g. a capacity portion of a fibre optic cable) is not an identified asset, unless it represents substantially all the capacity such that the customer obtains substantially all the economic benefits from using the asset
- separating components of a contract
 - for a contract that contains a lease component and additional lease and non-lease components, such as the lease of an asset and the provision of maintenance services, lessees shall allocate the consideration payable on the basis of the relative stand-alone prices
 - these shall be estimated if observable prices are not readily available
 - as a practical point, a lessee may elect, by class of underlying asset, not to separate non-lease components from lease components and instead account for all components as a lease
- accounting by lessees
 - immediately upon lease commencement a lessee recognises a right-of-use asset and a lease liability
 - the right-of-use asset is initially measured at the amount of the lease liability plus any initial direct costs incurred by the lessee
 - adjustments may also be required for lease incentives, payments at or prior to commencement and restoration obligations or similar
 - after lease commencement, a lessee shall measure the right-of-use asset using a cost model, unless:
 - the right-of-use asset is an investment property and the lessee fair values its investment property under IAS 40 or
 - the right-of-use asset relates to a class of PPE to which the lessee applies IAS 16's revaluation model, in which case all right-of-use assets relating to that class of PPE can be revalued
 - under the cost model a right-of-use asset is measured at cost less accumulated depreciation and accumulated impairment
 - the lease liability is initially measured at the present value of the lease payments payable over the lease term, discounted at the rate implicit in the lease if that can be readily determined
 - if that rate cannot be readily determined, the lessee shall use their incremental borrowing rate
 - amounts expected to be payable by the lessee under residual value guarantees are also included
 - the lease liability is subsequently re-measured to reflect changes in:
 - the lease term (using a revised discount rate);



- the assessment of a purchase option (using a revised discount rate);
 - the amounts expected to be payable under residual value guarantees (using an unchanged discount rate)
 - re-measurements are treated as adjustments to the right-of-use asset
 - any modification to the lease terms may also trigger a re-measurement of the lease liability unless those modifications are to be treated as separate leases
- sale and leaseback transactions
 - to determine whether the transfer of an asset is accounted for as a sale an entity applies the requirements of IFRS 15 for determining when a performance obligation is satisfied
 - if an asset transfer satisfies IFRS 15's requirements to be accounted for as a sale the seller measures the right-of-use asset at the proportion of the previous carrying amount that relates to the right of use retained
 - accordingly, the seller only recognises the amount of gain or loss that relates to the rights transferred to the buyer
 - if the fair value of the sale consideration does not equal the asset's fair value, or if the lease payments are not market rates, the sales proceeds are adjusted to fair value, either by accounting for prepayments or additional financing

WHEN YOU FINISHED THIS CHAPTER YOU SHOULD ATTEMPT THE [ONLINE F7 MCQ TEST](#)





Chapter 17

 Free lectures available for Paper F7 - [click here](#)

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.

Lined area for working out the carrying amount calculation.



WHEN YOU FINISHED THIS CHAPTER YOU SHOULD ATTEMPT THE [ONLINE F7 MCQ TEST](#)



Chapter 18

 **Free lectures available for Paper F7 - click here**

IAS 12 INCOME TAXES

- current tax should normally be recognised in the Statement of Profit or Loss and Other 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 Profit or Loss and Other Comprehensive Income often bears little relationship to the profit before tax figure in the Statement of Profit or Loss and Other 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 Profit or Loss and Other 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 Profit or Loss and Other 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 Profit or Loss and Other Comprehensive Income

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

Taxable profits

	\$'000	\$'000
Profit from operations	700	700
Royalty received	<u>-</u>	<u>60</u>
	700	760
Income tax @ 25%	<u>175</u>	<u>190</u>

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 depreciation 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 Profit or Loss and Other 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 provision). 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 Profit or Loss and Other Comprehensive Income

	2009 \$'000	2010 \$'000
Profit from operations	660	660
Warranties	(160)	-
	<u>500</u>	<u>660</u>
Income tax @ 25% on taxable profits	165	125
Profit after tax	<u>335</u>	<u>535</u>
Taxable profits		
Profit from operations	660	660
Warranty payments made	-	(160)
	<u>660</u>	<u>500</u>
Income tax @ 25%	<u>165</u>	<u>125</u>

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

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



WHEN YOU FINISHED THIS CHAPTER YOU SHOULD ATTEMPT THE [ONLINE F7 MCQ TEST](#)



Chapter 19

 **Free lectures available for Paper F7 - [click here](#)**

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, amortisation, impairment	1,200	
Investment income	(700)	
(Profit) / loss on asset disposal	(–)	
Interest expense	900	
Operating profit before working capital changes	<u>10,300</u>	
Decrease in inventories	2,700	
Increase in trade and other receivables	(800)	
Decrease in trade payables	<u>(2,300)</u>	
Cash generated from operations	9,900	
Increase in provisions	–	
Interest paid	(1,000)	
Income taxes paid	(3,400)	
Dividends paid*	<u>(3,000)</u>	
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	
Investment income received	400	
Dividends received	<u>600</u>	
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	<u>(2,900)</u>	
Net cash from financing activities		<u>3,500</u>
Net increase in cash and cash equivalents		5,600
Cash and cash equivalents at beginning of year (Note)		<u>(1,700)</u>
Cash and cash equivalents at end of year (Note)		<u><u>3,900</u></u>

* 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	<u>3,900</u>	<u>(1,700)</u>

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	<u>390,000</u>
Property, plant and equipment at net book value	<u>570,000</u>

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	<u>520,000</u>
Property, plant and equipment at net book value	<u>800,000</u>

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.



- **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 Profit or Loss and Other 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 Profit or Loss and Other Comprehensive Income taxation charge for 2009 was \$400,000.

What is the amount of taxation paid during the year?



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 Profit or Loss and Other 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	<u>832</u>		<u>681</u>	
		2,247		1,498
Current assets				
Inventory	619		701	
Receivables	584		492	
Investments	396		125	
Cash	<u>17</u>		<u>81</u>	
		1,616		1,399
TOTAL ASSETS		<u><u>3,863</u></u>		<u><u>2,897</u></u>
EQUITY AND LIABILITIES				
Equity				
\$1 equity shares	500		300	
Share premium	312		284	
Revaluation surplus	150		40	
Retained earnings	<u>1,612</u>		<u>1,210</u>	
		2,574		1,834
Non-current liabilities				
Provision for court case	73		50	
5% Debentures	<u>220</u>		<u>88</u>	
		293		138
Current liabilities				
Interest payable	100		30	
Bank	60		-	
Dividends payable	81		140	
Tax payable	238		226	
Trade payables	<u>517</u>		<u>529</u>	
		996		925
TOTAL EQUITY AND LIABILITIES		<u><u>3,863</u></u>		<u><u>2,897</u></u>

Statement of Profit or Loss and Other Comprehensive Income

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

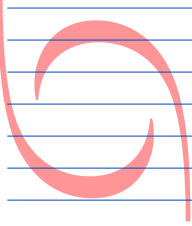


Notes:

- (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).

OpenTuition.com



- 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:

	<i>\$'000</i>
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 Profit or Loss and Other Comprehensive Income for the year ended 31 December, 2009 and her Statement of Financial Position extracts as at that date were:

Statement of Profit or Loss and Other Comprehensive Income

	<i>\$'000</i>	<i>\$'000</i>
Revenue		2,933
Cost of sales		1,748
Gross profit		1,185
Administrative expenses	317	
Distribution costs	438	
Profit before tax		430

Statement of Financial Position extracts

	<i>2009</i>	<i>2008</i>
	<i>\$'000</i>	<i>\$'000</i>
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

 Free lectures available for Paper F7 - [click here](#)

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
 - ratio analysis questions have traditionally been asked in a single-entity context but there is no reason to suggest that the examiner will not ask an interpretation question for a group
 - an analysis and interpretation of a group's performance and financial position could be asked where you are expected to compare with:
 - previous period's financial statements
 - another similar group for the same reporting period
 - industry average ratios



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 $\frac{\text{Interest bearing net debt}}{\text{Shareholders' funds} + \text{Interest bearing net debt}}$ 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	$\frac{\text{Dividend per share}}{\text{Mid market price (MMP)}}$	expressed as a percentage
Dividend cover	$\frac{\text{Earnings per share (EPS)}}{\text{Dividend per share}}$	expressed as a multiple
Price earnings ratio (PE Ratio)	$\frac{\text{MMP}}{\text{EPS}}$	expressed as a multiple
Earnings yield	$\frac{\text{EPS}}{\text{MMP}}$	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 Profit or Loss and Other Comprehensive Income for the year ended 31 December, 2009

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

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		<u>13,000</u>		<u>12,000</u>
		16,600		15,900
Current assets				
Inventory	225		120	
Receivables	280		125	
Cash	<u>15</u>		<u>65</u>	
		520		310
TOTAL ASSETS		<u><u>17,120</u></u>		<u><u>16,210</u></u>
Equity share capital \$1 each		4,000		4,000
Retained earnings		<u>12,048</u>		<u>12,008</u>
		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

Specialised, not-for-profit and public sector entities

Within the ACCA F7 syllabus is the topic "Explain how the interpretation of the financial statements of specialised, not-for-profit or public sector organisations might differ from that of a profit making entity by reference to the different aims, objectives and reporting requirements"

- it's easy when thinking about "financial statements" immediately to envisage a manufacturing or trading organisation
- but not all accountable organisations are either manufacturing or trading
- and you don't have to look far to think of an example! (Look at the bottom right-hand corner of this page!)
- but these "other" organisations include many diverse operations – some quick examples would include:
 - police
 - schools
 - charities
 - hospitals
 - universities
 - coast guard
 - armed forces
 - national utility providers
- yet, even though these organisations are not profit orientated, they are nevertheless accountable

Aims and objectives

- of the manufacturing / trading entity
 - the aims of a manufacturing entity are surely based around making profits to provide a return on the investment of their shareholders
 - as a secondary consideration (unfortunately) maybe the provision of quality goods at a reasonable price affordable by the end-user
 - almost a by-product of these is the provision of employment and the hope of continuity of employment for the entity's employees



- of the not-for-profit entity
 - as the title suggests, nirvana is not the aim of profit achievement
 - instead, the entity is often a service provider
 - the aim is to provide the relevant service efficiently, effectively and economically
 - efficiency is the ability to do things well, successfully, and without waste
 - effectiveness is measured as the achievement of all that was intended
 - economy is measured as the minimisation of expense whilst still achieving stated objectives
 - the distinction between efficiency and effectiveness may be blurred
 - so try these:
 - efficiency means “doing the thing right” whereas effectiveness means “doing the right thing”, or
 - “efficiency is doing things right; effectiveness is getting things done”
- given these different aims and objectives for the two types of entity, measurement of success must also be different
- we no longer can use “profitability” as a benchmark for success
- nor are inventory turnover, receivables days, payables days, interest cover, gearing, borrowing, earnings per share, price/earnings ratios applicable
- in fact, all the traditional ratio calculations become inapplicable when looking at not-for-profit entities
- but these entities are nevertheless accountable
- instead of calculated values like “return on capital employed” or “asset turnover ratio” interpretation of financial statements for not-for-profit entities needs to be adapted to be meaningful
- there are not many “money” based conclusions that can be inferred from not-for-profit entity financial statements
- instead, entities should be encouraged to disclose non-monetary information that will give a better insight into performance
- consider, for example, a charity that receives donations and applies the available money to “good causes”
- amongst others, applicable interpretation measures could include:
 - number of projects undertaken and the average cost of those projects compared with average budgeted cost
 - percentage of income from donations applied to the chosen causes (as distinct from paying the running costs of the charity and the salaries of the charity employees)
 - number of staff employed by the charity, their aggregate remuneration, and the number of unpaid charitable workers
 - estimated number of people directly benefitted by the application of the charitable projects
 - estimated dollar cost per person benefitted or persons benefitted per dollar spent
 - steps taken to ensure sustainability of the project
 - current year’s actual cost of such steps for projects completed in the past compared with historic estimates of those costs

WHEN YOU FINISHED THIS CHAPTER YOU SHOULD ATTEMPT THE [ONLINE F7 MCQ TEST](#)



Chapter 21

 **Free lectures available for Paper F7 - click here**

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 Profit or Loss and Other 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 for the year ended 28 February, 2009 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)

OpenTuition.com

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.

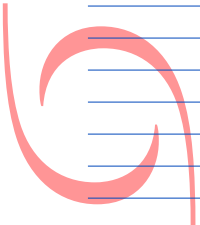
In addition, Edgars had the following outstanding financial instruments:

- 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.

OpenTuition.com



Lined area for student response.





Chapter 22

 Free lectures available for Paper F7 - [click here](#)

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 shareholders' funds
- objective of financial capital maintenance is to maintain shareholders' wealth
- operating 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:

<i>concept</i>	<i>unit of measurement</i>	<i>assets valuation</i>	<i>system of accounting</i>
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

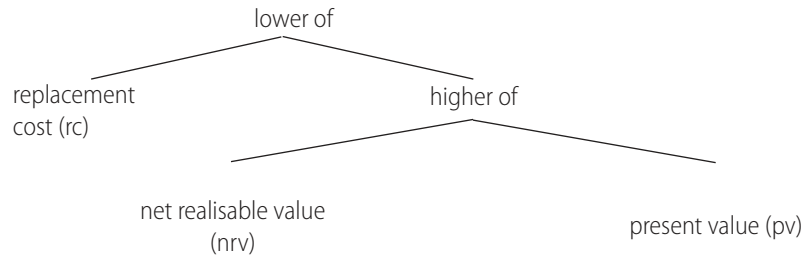
- **advantages:**
 - greater comparability resulting from asset value restatement
 - year by year comparisons have greater validity
 - subjectivity of other value measurement systems is avoided
 - being based on historic cost, as adjusted for indexation, the figures are auditable
 - gains and losses 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	<u>4</u>



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



WHEN YOU FINISHED THIS CHAPTER YOU SHOULD ATTEMPT THE [ONLINE F7 MCQ TEST](#)



Chapter 23

 Free lectures available for Paper F7 - [click here](#)

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



WHEN YOU FINISHED THIS CHAPTER YOU SHOULD ATTEMPT THE [ONLINE F7 MCQ TEST](#)

Chapter 24

 **Free lectures available for Paper F7 - [click here](#)**

IFRS 15 REVENUE FROM CONTRACTS WITH CUSTOMERS

Definitions within the standard:

- Contract:** is an agreement between two or more parties that creates enforceable rights and obligations
- Customer:** is a party that has contracted with an entity to obtain goods or services that are an output of that entity's ordinary activities in exchange for consideration
- Income:** is increases in economic benefits during the accounting period in the form of inflows or enhancements of assets or decreases of liabilities that result in an increase in equity, other than those relating to contributions from equity participants
- Performance obligation:** is a promise in a contract with a customer to transfer to the customer either:
- a good or service(or a bundle of goods or services) that is distinct, or
 - a series of distinct goods or services that are substantially the same and that have the same pattern of transfer to the customer
- Transaction price:** is the amount of consideration to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer, excluding amounts collected on behalf of third parties
- Control:** control of an asset is defined as the ability to direct the use of and obtain substantially all the remaining benefits from the use of the asset as well as the ability to exclude others from the use of the asset

NB in the rest of this chapter reference to "goods" shall apply equally to "services" and reference to "services" applies equally to "goods"

- Revenue:** is income arising in the course of an entity's ordinary activities and specifically:
- includes sales, services, interest, royalties and dividends
 - excludes trade discounts and VAT
 - should be measured at fair value of consideration received
 - if consideration is deferred, amount should be discounted
 - the difference between apparent sale value and fair value where sales are financed by the seller
- revenue from the sale of goods is 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



Two or more standards

- contracts with customers may fall partly within the scope of IFRS 15 and partly within the scope of a different IFRS
- if this different IFRS specifies how to measure and separate the two different elements, then that specification shall be followed first
- the element that remains after that separation is then treated under the concepts identified by IFRS 15

Core principle

The core principle of the IFRS is that an entity should recognise revenue reflecting the transfer of promised goods to customers representing the consideration to which the entity expects to be entitled in exchange for that transfer of those goods

5 step model

the IFRS identifies a 5 step model to be applied in achieving that core principle

- 1 identify the contract with the customer
- 2 identify the performance obligations in the contract
- 3 determine the transaction price
- 4 allocate the transaction price to the performance obligations in the contract
- 5 recognise revenue when the entity satisfies a performance obligation

The steps in greater detail

1 identify the contract with the customer

a contract with a customer falls within the IFRS if the following 5 conditions are met

- the contract has been approved by the parties to the contract
- each party's rights in relation to the goods to be transferred can be identified
- the payment terms for the goods to be transferred can be identified
- the contract has commercial substance
- it is probable that the consideration to which the entity is entitled in exchange for the goods will be recoverable

where a contract does not yet satisfy all those five criteria, the entity shall continuously re-assess the situation to determine whether all five are substantially satisfied and, when they are, the entity shall apply IFRS 15

modifications to contract terms or conditions

where there are modifications to the contract, and those modifications satisfy the above five criteria, the modification shall be treated as a separate contract

if the modifications do not satisfy the criteria, then the treatment for the original contract shall itself be modified

this modified treatment may be applied retrospectively or prospectively dependent upon whether the goods to be delivered under the modified contract are separable from those delivered before the modification



2 identify the performance obligations in the contract

(this point is best considered in the context of a contract involving, say, the delivery of plant accompanied by a continuing obligation to maintain the plant, that obligation to be satisfied over a period of, say, 5 years)

at the time the contract is entered into, the entity should assess the goods and services to be delivered and identify as a performance obligation:

- goods (or bundles of goods) that are distinct, and
- a series of distinct services that are substantially the same and that have the same pattern of transfer to the customer

this latter point concerning a series of services to be transferred in the same pattern is relevant if both of two pre-conditions are satisfied

- each distinct service in the series promised to be transferred consecutively to the customer would be a performance obligation satisfied over time, and
- a single method of measuring progress would be used to measure the entity's progress towards total satisfaction of the performance obligation to transfer those services to the customer

when are goods or services to be treated as distinct? Again, both of two pre-conditions are to be satisfied

- the customer shall be able to benefit from the goods on their own or in conjunction with other readily available resource, and
- the entity's promise to transfer those goods is separately identifiable from other contractual promises

how do we identify "separately identifiable"? Guidance within the IFRS suggests some factors, but these do not necessarily represent a comprehensive list.

The list includes:

- the entity does not provide a significant service of integrating the goods or services with other goods or services promised within the contract
- the services do not significantly modify other goods promised in the contract
- the services are not closely interrelated nor highly dependent on other goods promised in the contract

3 determine the transaction price

essentially, this is the price agreed within the contract in respect of the transfer of the goods in satisfaction of the performance obligation

but the contract may contain elements of the consideration that are variable

- examples of variable elements include:
 - discounts, incentives, rebates, credits, refunds, price concessions, performance bonuses and penalties
 - it is also possible that variability exists where the entity's right to consideration is dependent upon the occurrence or non-occurrence of some future event

variable consideration should only be included within the transaction price if it is highly probable that its inclusion will not result in a significant revenue reversal in the future as a result of the subsequent resolution of the uncertainty

finally, if the uncertainty is because of royalty revenue based upon usage under a license agreement, that revenue shall be recognised only when the actual usage has occurred



4 allocate the transaction price to the performance obligations in the contract

where a contract has multiple performance obligations, it is necessary to allocate the transaction price to those separate obligations.

again, think of it as a contract for the supply of plant with continuing obligation to service and maintain that plant over an extended period following delivery

this allocation problem should be based on the separate relative stand-alone values

if it is not readily available to determine such stand-alone values, the entity will have to make appropriate estimates

IFRS suggests possible methods to be adopted in that estimation exercise

- an adjusted market assessment approach
- an approach using expected cost plus appropriate margin
- and, in limited circumstances, a residual approach

any overall discount when compared with stand-alone values shall be allocated on a basis weighted to the performance obligations

where there is an agreement for payment in advance (or in arrears) the entity needs to consider whether the delay between performance and payment includes an element of financing

if it does involve financing, then an adjustment should be made under the principles of discounting for the time value of money

5 recognise revenue when the entity satisfies a performance obligation

revenue is recognised when control is passed

benefits in the context of control are the potential cash flows directly or indirectly associated with the use of the asset

revenue shall be allocated over a time period if any one of the following criteria is satisfied

- customer receives and consumes simultaneously the benefits provided by the entity at the time of the entity's performance
- performance provided by the entity creates or improves the performance of an asset already under the customer's control
- entity's performance does not create an asset with an alternative use to the entity
- entity has an enforceable right to receive payment for the performance completed to date

in the situation that an entity does not render performance over a period of time into the future, then performance must have been rendered at a single point in time

but the question arises, when is that single point in time when performance is rendered and control is passed?

IFRS suggests factors that may indicate that point in time, but these suggestions are not necessarily comprehensive. They include when the:

- entity gains the right to payment for the asset
- customer is recognised as having legal ownership of the asset
- entity has transferred physical possession of the asset
- significant risks and rewards of ownership have been transferred by the entity to the customer
- customer has accepted delivery of the asset



Costs of obtaining a contract

- where an entity incurs costs in the process of gaining a contract, these costs should be capitalised as an asset where the entity expects to recover those costs
- but the capitalisation of costs should be restricted to just those that the entity would not have incurred if the contract had not been successfully won
- an example would be the enabling fees or introduction fees payable to an intermediary or agent
- generally, costs involved in a contract are treated as assets only if all the following criteria are satisfied:
 - the costs are directly related to the contract
 - the costs are expected to be recovered, and
 - the costs either generate or improve the entity's resources that will be used in satisfying the performance obligations in the future
- these costs include matters such as direct labour, materials and overheads related to the contract and the asset thus recognised shall be amortised on a basis consistent with the pattern of the transfer of goods and services transferred under the contract
- numerical examples of the accounting treatment are in chapter 13 "Accounting treatment of construction contracts"

Presentation in the financial statements

- a contract liability arises where a customer has paid in advance of the receipt goods or services under the contract
- a contract asset arises where goods or services have been rendered to a customer but the customer has not yet settled the amount in consideration of those goods or services
- where it happens that the full recoverability of an asset arising under a contract is in doubt, then an impairment loss should be recognised as an expense

Disclosures

- in general, sufficient disclosure should be made of information in order to enable a user of financial statements to understand fully the nature, amounts, timing and uncertainty of revenues and cash flows arising from contracts with customers
- such information should be qualitative as well as quantitative in nature

WHEN YOU FINISHED THIS CHAPTER YOU SHOULD ATTEMPT THE [ONLINE F7 MCQ TEST](#)





Chapter 25

 Free lectures available for Paper F7 - [click here](#)

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

WHEN YOU FINISHED THIS CHAPTER YOU SHOULD ATTEMPT THE [ONLINE F7 MCQ TEST](#)





Chapter 26

 Free lectures available for Paper F7 - [click here](#)

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 Profit or Loss and Other Comprehensive Income includes the amortisation expense
- if research and development, how much charged this year as an expense

WHEN YOU FINISHED THIS CHAPTER YOU SHOULD ATTEMPT THE [ONLINE F7 MCQ TEST](#)



Chapter 27

 **Free lectures available for Paper F7 - [click here](#)**

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 Profit or Loss and Other 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 \Rightarrow TNCA)
 - development with a view to sell (investment property \Rightarrow inventory)
 - end of owner occupation (TNCA \Rightarrow investment property)
 - start of operating lease (investment property \Rightarrow inventory)
 - end of construction or development (assets in the course of construction \Rightarrow 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 Profit or Loss and Other 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

WHEN YOU FINISHED THIS CHAPTER YOU SHOULD ATTEMPT THE [ONLINE F7 MCQ TEST](#)



Chapter 28

 Free lectures available for Paper F7 - [click here](#)

IFRS 9 FINANCIAL INSTRUMENTS

- a financial instrument is a contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity
- it's a contract – a piece of paper – evidencing an asset of one entity and an obligation (or increased equity) of another
- financial instrument assets may be
 - a debt asset which will be received some time in the future
 - for example, an investment in another entity's debentures, or
 - an equity asset
 - for example, an investment in another entity's shares, but not an investment in a subsidiary, associate, joint venture nor pension fund
- debt assets
 - initial measurement is at fair value and includes transaction costs
 - the only exception to this transaction cost inclusion rule is if the investment is not classed as at "fair value through profit and loss" (FVTPL)
 - subsequent measurement is either at:
 - amortised cost, or
 - fair value
 - a debt asset may only be valued at amortised cost if it satisfies both of two tests
 - the business model test – the asset is held with the intention of realising its cash flows rather than being held for early sale, and
 - the cash flow characteristics test – the asset terms are such that cash flows will arise on specific dates in the future representing interest payments and repayments of principal
 - if either one of these tests is not satisfied, the asset must be classified as at FVTPL
 - even if both tests are satisfied, nevertheless the asset may be valued at FVTPL if, by doing so, it eliminates or significantly reduces an inconsistency in measurements (the fair value option)
 - annual changes in value go through statement of profit or loss



- equity assets
 - these are measured at fair value...
 - ... with any change in value being reflected in statement of profit or loss
 - ...unless an election is made at the date of acquisition to deal with changes in value through the statement of other comprehensive income (FVTOCI)
 - such an election cannot be changed – it's irrevocable
 - so, if the election is made, only the dividend income from the investment will be recognized within the statement of profit or loss
 - if the investment was made with the intention of trading those shares, then it is not possible to elect to classify the investment as at FVTOCI
 - on disposal, gains and losses previously recognized through statement of other comprehensive income cannot be recycled through the statement of profit or loss
 - instead, on disposal, previously recognized gains and losses will be transferred to retained earnings through the statement of changes in equity
- reclassification
 - if an election was made to classify as at FVTOCI, then that asset cannot be reclassified
 - if the fair value option has been exercised for a debt asset, that too cannot be reclassified
 - but if the business model objective has changed, a debt asset instrument may be reclassified between FVTPL and amortised cost, and vice versa
 - such a reclassification does not operate retrospectively, so any previously recognized gains or losses are not restated
- impairments
 - IFRS 9 suggests that only assets held at amortised cost should be subjected to annual impairment review
 - but it is proposed that an "expected loss" model be introduced so investors holding financial assets will be required to determine and account for expected losses when the asset is acquired rather than wait until the investee entity defaults
 - this will be achieved by making allowance for the expected losses over the life of the asset by acknowledging a potential reduction in the income stream from that asset
- examples
 - 1 The accounting treatment on the disposal of an equity investment classified as at FVTOCI
 - where shares were acquired some years ago for, say, \$6,000 an election was made on acquisition to classify as at FVTOCI
 - throughout the period of ownership, the investment has been annually remeasured with increases and decreases reflected in other comprehensive income and credited to "Other components of Equity"
 - at the last year end, the fair value had risen to \$9,600 and, at the date of disposal during this year, it had risen further to \$9,800
 - only \$200 will be recognized through this year's statement of profit or loss. The previous gains of \$3,600 will be transferred from "Other components of Equity" to "Retained earnings" through the statement of changes in equity
 - 2 Illustration of how the "expected loss" model will work
 - A portfolio of debt instruments has been acquired and recognized at its cost of \$40,000. The assets satisfy both the business model test and the cash flow characteristics test and have been accounted for at amortised cost.
 - The actual and effective rate of return is 6% but there is an element of doubt about the continuing viability of the investee entities and, although there has been no default this year, it is considered likely that the actual rate of return



- in the long run will be only 4%
- in applying the expected loss model, only 4% return on the portfolio will be recognized in the statement of profit or loss. The amount to be recognized before the expected loss review was $6\% \times \$40,000$ ie \$2,400 but the expected loss restricts the amount to be recognized to just $4\% \times \$40,000$ ie \$1,600
- the "missing" 2% ie \$800 will be credited to the asset account reducing the value of the portfolio to $\$40,000 - \800 ie \$39,200
- the double entry will therefore be:

Dr	Cash		2,400	
	Cr	Income		1,600
	Cr	Asset		800

financial instrument liabilities

- a financial instrument liability arises, for example, when a purchaser of goods or services on credit receives an invoice from the supplier – remember, it's a contract
- for our purposes, and for the exam, it's more likely to arise when an entity raises finance by way of a debenture issue, or
- equally, when an entity raises finance by way of a share issue, a financial instrument is created
- financing of these two types of instrument is radically different and that's why it is important that they be correctly classified
- a dividend paid on an equity share is an appropriation of profits and is accounted for through the statement of changes in equity whereas
- interest paid on a debenture is a finance charge reflected in the statement of profit or loss

equity instruments

- an equity instrument evidences a residual interest in the assets of an entity after all liabilities have been settled in the event of a liquidation
- initial measurement is at fair value less any associated issue costs
- beware the share premium!
- illustration – an entity issues 500,000 \$1 equity shares for \$2,20 each and pays issue costs of \$10,000
- the double entry would be:

Dr	Cash ($500,000 \times \$2,20$) – \$10,000		1,090,000	
	Cr	Share capital ($500,000 \times \$1$)		500,000
	Cr	Share premium ($500,000 \times \$1,20$) – \$10,000		590,000

- having recorded the issue of shares at face value and the associated share premium (net of issue costs) the equity instrument is not now remeasured
- any increase in the value of the shares is enjoyed by the shareholders – not by the entity



- financial liabilities (as distinct from equity instruments)
 - these may be classified as either "at amortised cost" or "at FVTPL"
 - if at amortised cost (applicable to the majority of financial instrument liabilities) initial measurement is at fair value less any related transaction costs
 - a financial instrument liability considers the effective rate (given in an exam question) compared with the nominal (coupon) rate
 - illustration – an entity raises finance by issuing \$600,000 4% debentures, redeemable in 3 years' time at a premium of \$33,367. You are told that the effective rate of interest is 7%. No election has been made to treat the liability at FVTPL so it will be accounted for on an amortised cost basis. Issue costs of \$20,000 were incurred

this illustration involves initial measurement at fair value less related transaction costs

on issue, the double entry will be:

Dr	Cash with the net receipts	580,000	
	Cr Liabilities – debenture		580,000

in order to calculate the annual finance charge it is advisable to set out a table as follows:

	brought forward	effective interest 7%	interest paid 4%	carried forward
year 1	580,000	40,600	24,000	596,600
year 2	596,600	41,762	24,000	614,362
year 3	614,362	43,005	24,000	633,367

note, if the interest rate / coupon rate had been zero, then no amount of interest would be paid. The only payment would have been the amount paid on maturity at the end of the 3 years. But the annual finance charge using the effective interest rate would be shown

- compound / mixed instruments
 - these are financial instruments which have both a debt element and an equity element
 - classically, a convertible debenture
 - you will not be asked in an exam to calculate the effective rate of interest on any financial instrument
 - if it's relevant, it will be stated in the question
 - in the situation of a compound instrument being issued, the issuing entity will need to value separately the debt element and, by default, the equity element
 - in valuing the debt element, discounted cash flow techniques are applied to the future cash flows attributable to the debt
 - by deducting the total present value of the debt element from the face value of the compound instrument, we are left with the equity element
 - illustration – a \$400,000 4% debenture was issued, redeemable at par in 3 years' time. We are told that the effective rate of interest is 7%. In this illustration, there are no transaction costs but, if there had been, these would have been proportionally allocated between the debt and the equity elements
 - the debenture can be repaid in cash or the lender can opt to convert the debt into equity shares on agreed terms of, say, 750 \$1 equity shares for each \$1,000 debenture



- we need a table to calculate the present value of the cash flows related to the debt element

	flow	discount factor @ 7%	present value
year 1	16,000	· 9346	14,954
year 2	16,000	· 8734	13,974
year 3	416,000	· 8163	339,580
			<u>368,508</u>

- the double entry to record the issue of the convertible debenture would be:

Dr	Cash	400,000	
	Cr "Other components of equity"		31,492
	Cr Financial liability, debenture		368,508

- to calculate the amounts to be included within the financial statements, it is advisable to set up a table as follows:

	brought forward	effective interest 7%	interest paid 4%	carried forward
year 1	368,508	25,796	16,000	378,304
year 2	378,304	26,481	16,000	388,785
year 3	388,785	27,215	16,000	400,000

- in year 1 there will be a charge to the statement of profit or loss of \$25,796 even though only \$16,000 is actually paid. The difference of \$9,796 is added to the financial liability in the statement of financial position
- similarly, in year 2 the finance charge in the statement of profit or loss will be \$ 26,481 and the liability will be increased by \$10,481 ie \$26,481 - \$16,000 paid
- at the end of year 3, the liability now stands at \$400,000 and will be either repaid in cash or, if the lender chooses, it could be settled by the issue of 300,000 \$1 equity shares in which case the double entry would be:

Dr	4% debenture	400,000	
	Cr Share capital		300,000
	Cr Share premium		100,000

WHEN YOU FINISHED THIS CHAPTER YOU SHOULD ATTEMPT THE [ONLINE F7 MCQ TEST](#)





Chapter 29

 **Free lectures available for Paper F7 - click here**

AGRICULTURE

- Agriculture standardises the accounting for agricultural activity
 - that is:–
 - the conversion of biological assets
 - into agricultural produce
 - as a generalisation, the standard requires biological assets to be
 - measured at “fair value less costs to sell”

definitions

- biological assets – living plants and animals
- agricultural produce – the produce harvested from the biological assets
- costs to sell – incremental costs directly attributable to the disposal of an asset excluding finance costs and taxation

initial recognition

- an entity should recognise a biological asset or agricultural produce only when the entity:
 - controls the asset
 - as a result of past events
 - it is probable that future economic inflows will result
 - the asset and inflows are capable of reliable measurement

measurement

- on initial recognition and on subsequent reporting dates, **biological assets** should be measured at fair value less estimated costs to sell, unless....
 - fair value cannot be reliably measured (see below!)
 - **agricultural produce** should be measured at fair value less estimated costs to sell at the point of harvest
 - because harvested produce is a marketable commodity, there is no exception for measurement unreliability
 - any gain on initial recognition of biological assets at fair value less costs to sell, and any changes during a period in fair value less costs to sell of biological assets are reported in the statement of profit or loss
 - similarly, any gain on initial recognition of agricultural produce at fair value less costs to sell should be included in the statement of profit or loss for the period in which it arises
 - all costs related to biological assets measured at fair value are recognised as expenses in the period in which they are incurred with the exception of the purchase cost of those assets

- **from above**, there remains a problem with measurement of a biological asset for which fair value cannot be reliably measured
 - it is conceivable that, at initial measurement, there is no quoted price in an active market for the biological asset ...
 - and no alternative appropriate and workable method exists



- in this case, the asset should be measured at cost less accumulated depreciation and impairment losses
 - but the entity must still measure all of its other biological assets at fair value less costs to sell
 - and if circumstances change and fair value becomes reliably measurable, a switch to fair value less costs to sell is required
- **guidance on the measurement of fair value**
 - best measure is "quoted market price in an active market"
 - if no active market, a market-based price such as the most recent market price for that type (or similar) asset
 - if market-based prices not available, the net present value of related cash flows from that asset, discounted at the entity's current cost of capital
 - in rare circumstances, cost may be taken as fair value where there has been little or no change to the biological asset since acquisition or where such change is not likely to have a material effect on value
 - the fair value of a biological asset is based on current prices and is not reflective of actual prices agreed in binding sales contracts requiring delivery at some time in the future
 - **sundry points**
 - change in fair value of biological assets is part due to physical change (asset is one year older) and part due to market price change
 - separate disclosure of the two elements is encouraged but not required
 - fair value measurement stops at harvest. After that, IAS on inventory applies
 - agricultural land is accounted for under IAS on PPE
 - but agricultural assets attached to the land (for example fruit trees) are measured separately from the land
 - intangible agricultural assets (for example milk quotas) are accounted for under IAS intangible assets
 - government grants unconditionally received in respect of biological assets measured at fair value less costs to sell are accounted for as income in the period when the grant is receivable
 - but if the grant is conditional, it shall be recognised as income only when the conditions have been met
 - this includes grants receivable where an entity is required NOT to engage in agricultural activities



EXAMPLE 1

Numbers prepares financial statements to 30 September each year. On 1 October, 2012 Numbers carried out the following transactions:

- Purchased a large piece of land for \$47 million
- Purchased 10,000 dairy cows (average age at 1 October, 2012 two years) for \$2.35 million
- Received a grant of \$940,000 towards the acquisition of the cows. This grant was non-returnable

During the year ending 30 September, 2013 Numbers incurred the following costs:

- \$1,175,000 to maintain the condition of the animals (food and protection).
- \$705,000 in breeding fees to a local farmer

On 1 April, 2013 5,000 calves were born. There were no other changes in the number of animals during the year ended 30 September, 2013

At 30 September, 2013 Numbers had 10,000 litres of unsold milk in inventory

The milk was sold shortly after the year end at market prices

Information regarding fair values is as follows:

Item	Fair value less point of sale costs		
	1 October 2012	1 April 2013	30 September 2013
	\$	\$	\$
Land (\$million)	47	51.7	55.4
New born calves (per calf)	47	49.35	51.7
Six month old calves (per calf)	54.05	56.4	58.15
Two year old cows (per cow)	211.5	216.2	220.9
Three year old cows (per cow)	218.55	223.25	227.95
Milk (per litre)	1.41	1.29	1.29

Required:

- (a) Discuss how the IAS 41 requirements regarding the recognition and measurement of biological assets and agricultural produce are consistent with the IASC Framework for the Preparation and Presentation of Financial Statements. (8 marks)
- (b) Prepare extracts from the statement of profit or loss and the statement of financial position that show how the transactions entered into by Numbers in respect of the purchase and maintenance of the dairy herd would be reflected in the financial statements of the entity for the year ended 30 September, 2013. You do not need to prepare a reconciliation of changes in the carrying amount of biological assets. (17 marks)



WHEN YOU FINISHED THIS CHAPTER YOU SHOULD ATTEMPT THE [ONLINE F7 MCQ TEST](#)



Chapter 30

 **Free lectures available for Paper F7 - [click here](#)**

THE EFFECTS OF CHANGES IN FOREIGN EXCHANGE RATES

Objective of IAS 21

- to prescribe how to include foreign currency transactions and foreign operations in the financial statements of an entity
- to prescribe how to translate financial statements into a presentation currency

Principal issues

- which exchange rates to use
- how to report the effects of changes in exchange rates in the financial statements

Definitions

- **functional currency:** the currency of the primary economic environment in which the entity operates
- **presentation currency:** the currency in which financial statements are presented
- **exchange difference:** the difference resulting from translating a given number of units of one currency into another currency at different exchange rates

Basic steps for translating foreign currency amounts into the functional currency

- reporting entity determines its functional currency
- then translates all foreign currency items into its functional currency
- then reports the effects of such translation



Foreign currency transactions – initial recognition

- foreign currency transactions should be recorded initially at the actual rate of exchange at the date of the transaction
- this could cause enormous expense, potentially totally out of proportion to the amounts involved
- therefore average rate is acceptable if it is a reasonable approximation of actual
- Subsequent re-measurement at year end date
- monetary items should be reported using the closing rate
- where a transaction is entered into at a contracted rate, then that is the rate that shall be applied to that transaction throughout its existence
- non-monetary items carried at historical cost should be reported using the exchange rate at the date of the acquisition
- non-monetary items carried at fair value should be reported at the rate that existed when the fair values were determined

When monetary items are settled

- any exchange difference that arises when monetary items are settled is reported in the statement of profit or loss in the period

Translation from the functional currency to the presentation currency

- where the functional currency of an entity is to be translated into a different presentation currency, the following steps are taken:
 - assets and liabilities are translated at the closing rate at the year end date
 - income and expenses are translated at exchange rates at the dates of the transactions though average rate is acceptable as an approximation
 - all resulting exchange differences are recognised in the statement of other comprehensive income

Disclosure

- the amount of exchange differences recognised in profit or loss
- net exchange differences recognised in other comprehensive income and accumulated in a separate component of equity
- a reconciliation of the amount of such exchange differences at the beginning and end of the period
- when the presentation currency is different from the functional currency, disclose that fact together with the functional currency and the reason for using a different currency for presentation
- any change in the functional currency and the reason for that change



Convenience translations

- sometimes, an entity displays its financial statements or other financial information in a currency that is different from either its functional currency or its presentation currency simply by translating all amounts at end-of-period exchange rates
 - this is described as a convenience translation
 - a consequence of making a convenience translation is that the resulting financial information does not comply with IFRS
- in this case, the following disclosures are required:
- clear identification of the information as supplementary information to distinguish it from the information that complies with IFRS
 - disclosure of the currency in which the supplementary information is displayed
 - disclosure of the entity's functional currency and the method of translation used to determine the supplementary information

EXAMPLE 1

On 19 December, 2015 Numea Inc. bought goods from Mainwaring plc for 80,000 British Pounds, and on the same day bought goods from Cholmondley SA for 20,000 Zambian Kwacha. At the date of the transactions, the exchange rates were:

\$1 = 0.69 Pounds (GBP)

\$1 = 9.23 Kwacha (ZMW)

The Mainwaring plc transaction was entered into at a contracted rate of exchange of \$1 = 0.7 GBP

Numea Inc paid both his creditors on 3 February, 2016 when the exchange rates were:

\$1 = 0.72 GBP = 9 ZMW

On 31 December, 2015, Numea Inc's financial year end, the equivalent rates were: \$1 = 0.68 GBP = 9.3 ZMW

Show how these transactions would be reflected in Numea Inc's accounting records.



WHEN YOU FINISHED THIS CHAPTER YOU SHOULD ATTEMPT THE [ONLINE F7 MCQ TEST](#)



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

No EXAMPLES

Chapter 3

ANSWER TO EXAMPLE 1

Statement of Income

Profit for the year from continuing operations	421
Statement of Profit or Loss and Other Comprehensive Income	<u>421</u>
Profit for the period	421
Other recognised income and expense	
Surplus on property revaluation	105
Impairment loss	<u>(25)</u>
	80
	<u>501</u>

Statement of Changes in Equity

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



Chapter 4**ANSWER TO EXAMPLE 1****Ruta Co Statement of Profit or Loss and Other Comprehensive Income for the year ended 31 December, 2009**

	\$000	\$000
	2009	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)
	<u>230</u>	<u>160</u>

Chapter 5**ANSWER TO EXAMPLE 1****Adomas Statement of Income for the year ended 31 December, 2009**

	2009	2008
	\$'000	\$'000
Revenue	2,600	2,500
Costs and expenses	(1,400)	(1,200)
Profit for the year	<u>1,200</u>	<u>1,300</u>

Adomas Statement of Financial Position as at 31 December, 2009

	2009	2008
	\$'000	\$'000
TNCA	2,300	1,500
Current assets	1,700	800
	<u>4,000</u>	<u>2,300</u>
\$1 Equity shares	600	600
Retained earnings	2,700	1,500
Revaluation reserve	300	–
	3,600	2,100
Current liabilities	400	200
	<u>4,000</u>	<u>2,300</u>

Adomas Statement of Profit or Loss and Other Comprehensive Income

	2009	2008
	\$'000	\$'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	<u>1,500</u>	<u>800</u>
Affect of material error		(500)



Answers to Examples

Adomas Statement of Changes in Equity

	<i>Share capital</i>	<i>Revaluation reserve</i>	<i>Retained earnings</i>	<i>Total</i>
	<i>\$'000</i>	<i>\$'000</i>	<i>\$'000</i>	<i>\$'000</i>
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	<u>600</u>	<u>300</u>	<u>2,700</u>	<u>3,600</u>

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		<u>3,000</u>
		53,000
Current assets		
Inventory	8,000	
Receivables	6,000	
Cash	<u>1,000</u>	
		<u>15,000</u>
		<u>68,000</u>
Equity		
\$1 Equity shares		40,000
Retained earnings		<u>20,000</u>
		60,000
Current liabilities		<u>8,000</u>
Total equity and liabilities		<u>68,000</u>

ANSWER TO EXAMPLE 2

Size of Investment

0% to < 20%

20% to ≤ 50%

> 50%

Extent of influence achieved

No significant influence

Significant

Total control

Accounting treatment

As an investment, accounting only for dividends received

As an associate under the Equity Method

Acquisition accounting



Chapter 7

ANSWER TO EXAMPLE 1

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

		\$
Other assets	(30 + 20)	<u>50,000</u>
\$1 Equity shares	Only Rasa	20,000
Retained earnings	See note (p34)	<u>22,000</u>
		42,000
Liabilities	(6 + 2)	<u>8,000</u>
		<u><u>50,000</u></u>

ANSWER TO EXAMPLE 2

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

		\$
Other assets	(40 + 26)	<u>66,000</u>
\$1 Equity shares	Only Rasa	20,000
Retained earnings	((31 + 100% (14 - 10))	<u>35,000</u>
		55,000
Liabilities	(7 + 4)	<u>11,000</u>
		<u><u>66,000</u></u>

ANSWER TO EXAMPLE 3

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

		\$
Other assets	(40 + 30)	<u>70,000</u>
\$1 Equity shares	Only Aurimas	10,000
Retained earnings	(W3)	<u>49,000</u>
		59,000
Liabilities		<u>11,000</u>
		<u><u>70,000</u></u>

Workings W1



W2 Goodwill

not yet applicable

W3 Consolidated retained earnings

per question

– pre acquisition

∴ post acquisition

Aurimas' share

A	O
42,000	15,000
<u>–</u>	<u>(8,000)</u>
42,000	<u>7,000</u>
<u>7,000</u>	<u>100%</u>
<u><u>49,000</u></u>	



Answers to Examples

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
		<u>77,000</u>
\$1 Equity shares	Only Maruta	25,000
Retained earnings	(W3)	36,000
		<u>61,000</u>
Liabilities	(9 + 7)	16,000
		<u><u>77,000</u></u>

Workings

W1



W2

Goodwill		
Cost of investment		30,000
Net assets @ doa		
\$1 Equity shares	15,000	
Retained earnings	<u>5,000</u>	
		<u>20,000</u>
Goodwill		<u><u>10,000</u></u>

W3

Consolidated retained earnings		
per question	M	L
	36,000	5,000
– pre acquisition	<u>–</u>	<u>(5,000)</u>
∴ post acquisition	36,000	<u>–</u>
M's share	<u>–</u>	<u>100%</u>
	<u><u>36,000</u></u>	



Answers to Examples

ACCA F7 March-June'18 Examinations

ANSWER TO EXAMPLE 5

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

	\$
Goodwill (W2)	11,000
Other assets (100 + 150)	250,000
	<u>261,000</u>
\$1 Equity shares	50,000
Retained earnings (W3)	118,500
NCI (W4)	32,500
	<u>201,000</u>
Liabilities (40 + 20)	60,000
	<u><u>261,000</u></u>



W2 Goodwill

Cost of investment	80,000
NCI investment valuation	23,000
	<u>103,000</u>
NA @ DOA	
\$1 Equity shares	32,000
Ret earnings	<u>60,000</u>
	92,000
Goodwill	<u><u>11,000</u></u>

W3 Consolidated retained earnings

	<i>R</i>	<i>I</i>
per q	90,000	98,000
- pre acq		60,000
∴ post acq		<u>38,000</u>
our share	<u>28,500</u>	75%
	<u><u>118,500</u></u>	

W4 NCI (25%)

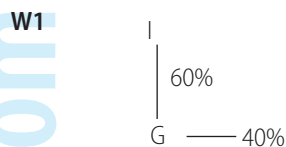
Value @ doa	23,000
Share of S post acq ret'd 25% x 38,000	9,500
	<u>32,500</u>
Less their share of impairment – none, originally valued on a proportional basis	–
	<u><u>32,500</u></u>



Answers to Examples

ANSWER TO EXAMPLE 6

	\$
Goodwill (W2)	33,000
Other net assets (60 + 190)	<u>250,000</u>
	<u>283,000</u>
\$1 Equity shares	70,000
Retained earnings (W3)	132,000
NC Interest (W4)	<u>81,000</u>
	<u>283,000</u>

**W2** Goodwill

Cost of investment	100,000
Nci investment valuation ((40% x 120) + 5)	<u>53,000</u>
	153,000
Net assets @ doa	
\$1 Equity shares	80,000
Retained earnings	<u>40,000</u>
	<u>120,000</u>
Goodwill	<u>33,000</u>

W3 Consolidated retained earnings

per q	90,000	110,000
- pre acq		<u>(40,000)</u>
∴ post acq		<u>70,000</u>
our share	<u>42,000</u>	60%
	<u>132,000</u>	

W4 NCI (40%)
Value @ doa
Share of S post acq ret'd 40% × (110,000 - 40,000)

	53,000
	<u>28,000</u>
	<u>81,000</u>

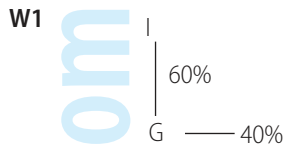


Answers to Examples

ACCA F7 March-June'18 Examinations

ANSWER TO EXAMPLE 7

	\$
Goodwill (W2)	35,000
Other net assets (60 + 190)	250,000
	<u>285,000</u>
\$1 Equity shares	70,000
Retained earnings (W3)	132,000
NC Interest (W4)	83,000
	<u>285,000</u>

**W2** Goodwill

Cost of investment	100,000
Nci investment valuation	55,000
	<u>155,000</u>
Net assets @ doa	
\$1 Equity shares	80,000
Retained earnings	<u>40,000</u>
	<u>120,000</u>
Goodwill	<u>35,000</u>

W3 Consolidated retained earnings

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

W4 NCI (40%)
Value @ doa
Share of S post acq ret'd 40% × (110,000 - 40,000)

55,000
28,000
<u>83,000</u>

ANSWER TO EXAMPLE 8

	\$
Goodwill (W2)	32,800
Other assets (60 + 190)	250,000
	<u>282,800</u>
\$1 Equity shares	70,000
Retained earnings (W3)	132,000
Nci (W4)	80,800
	<u>282,800</u>



Answers to Examples**W1** No change**W2** Goodwill

Cost of investment	100,000
Nci investment valuation $40\% \times 80,000 \times \1.65	<u>52,800</u>
	152,800
Net assets @ doa	
\$1 Equity shares	80,000
Retained earnings	<u>40,000</u>
	120,000
Goodwill	<u><u>32,800</u></u>

W3 No change**W4** NCI (40%)

Value @ doa	52,800
Share of S post acq ret'd $40\% \times 70,000$	<u>28,000</u>
	<u><u>80,800</u></u>

ANSWER TO EXAMPLE 9

Ivona / Guido (1) impairing goodwill

		\$
Goodwill	(W2)	31,500
Other net assets		<u>250,000</u>
		<u>281,500</u>
\$1 Equity shares		70,000
Retained earnings	(W3)	129,900
NC Interest	(W4)	81,600
		<u><u>281,500</u></u>

W1 No change**W2** Goodwill

Goodwill as calculated	35,000
Impair by 10%	<u>3,500</u>
	<u><u>31,500</u></u>

W3 Consolidated retained earnings

As calculated	132,000
Less goodwill impairment, Ivona's share only ($60\% \times 3,500$)	<u>(2,100)</u>
	<u><u>129,900</u></u>

W4 NCI (40%)

Value @ doa	55,000
Share of post acq retained ($40\% \times 70,000$)	<u>28,000</u>
	83,000
Less: share of impairment ($40\% \times 3,500$)	<u>1,400</u>
	<u><u>81,600</u></u>



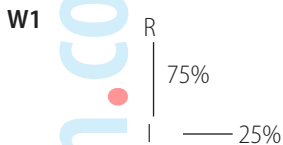
Answers to Examples

ACCA F7 March-June'18 Examinations

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
	<u>59,000</u>
\$1 Equity shares	5,000
Retained earnings (W3)	41,875
NC Interest (W4)	7,625
	<u>54,500</u>
Liabilities (1 + 3.5)	4,500
	<u>59,000</u>



W2

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

W3 Consolidated retained earnings

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

W4

Nci (25%)	
Value @ doa	7,000
Share of S post acq ret'd 25% x 2,500	625
	<u>7,625</u>



Answers to Examples

ANSWER TO EXAMPLE 11

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

INCA	(W2)	\$
Non-depreciable non-current		99,500
Depreciable non-current		15,000
Other assets	(350 + 300)	18,000
		<u>650,000</u>
		<u>782,500</u>
\$1 Equity shares	D Only	200,000
Retained earnings	(W3)	393,600
NC Interest	(W4)	78,900
		<u>672,500</u>
Liabilities	(40 + 70)	110,000
		<u>782,500</u>

W1



W2

Goodwill		
Cost of investment		250,000
Nci investment valuation		<u>64,500</u>
		314,500

Net assets @ doa		
\$1 Equity shares	130,000	
Retained earnings	20,000	
Fair value adjustments		
Inventory	20,000	
Non-depreciable non-current	15,000	
Depreciable non-current	<u>30,000</u>	
		<u>215,000</u>
		<u>99,500</u>

W3

Consolidated retained earnings		
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) $30,000 \times 60\%$		<u>18,000</u>
		133,000
Less pre-acq		<u>85,000</u>
		<u>48,000</u>
Dalius's share	33,600	70%
CSFP	<u>393,600</u>	

W4

Nci (30%)		
Value @ doa		64,500
Share of S post acq ret'd $30\% \times 48,000$		<u>14,400</u>
		<u>78,900</u>



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
		<u>360,000</u>
		<u>910,000</u>
\$1 Equity shares	J Only	500,000
Retained earnings	(W3)	221,000
NC Interest	(W4)	69,000
		<u>790,000</u>
Liabilities	(110 + 10)	120,000
		<u>910,000</u>
W1	<pre> J 70% D — 30% </pre>	
W2	Goodwill	
	Cost of investment	140,000
	Nci investment valuation	60,000
		<u>200,000</u>
	Net assets @ doa	
	\$1 Equity shares	200,000
	Retained earnings	<u>—</u>
		<u>200,000</u>
	No Goodwill	<u>—</u>
W3	Consolidated retained earnings	
	per question	Jurate Dovile
	less pre-acq	200,000 30,000
	∴ post acq	<u>—</u>
	Jurate's share	<u>30,000</u>
		21,000 70%
		<u>221,000</u>
W4	NC Interest (30%)	
	Value @ doa	60,000
	Share of S post acq ret'd 30% x 30,000	9,000
		<u>69,000</u>

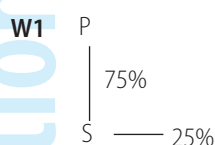


Answers to Examples

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	
		<u>348</u>	
			<u>1,098</u>
\$1 Equity shares	P Only		450
Retained earnings	(W3)		403.5
NC Interest	(W4)		<u>84.5</u>
			938
Liabilities	(130 + 30)		<u>160</u>
			<u>1,098</u>

**W2** Goodwill

Cost of investment	150,000
Nci investment valuation	<u>50,000</u>
	200,000
Net assets @ doa	
\$1 Equity shares	200,000
Retained earnings	<u>-</u>
	<u>200,000</u>
No Goodwill	<u>-</u>

Provision for Unrealised Profit calculation (PUP)

C	+	π	=	SP
100	+	25	=	?
			=	125

So $\frac{25}{125}$ or $\frac{1}{5}$ is the profit element $\frac{1}{5} \times 60,000 = 12,000$ pup.Reduce inventory and **SIGNE'S** retained earnings.**W3** Consolidated retained earnings

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

W4 Nci (25%)

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



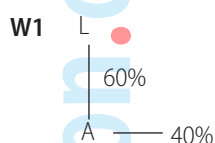
Answers to Examples

ACCA F7 March-June'18 Examinations

ANSWER TO EXAMPLE 3

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

		\$'000
TNCA	(400 - 5 + 240)	635
Current assets	(440 + 510)	950
		<u>1,585</u>
\$1 Equity shares	L Only	300
Retained earnings	(W3)	767
NC Interest	(W4)	288
		<u>1,355</u>
Current liabilities	(200 + 30)	230
		<u>1,585</u>



W2

Goodwill		
Cost		160,000
Nci investment valuation		158,000
		<u>318,000</u>
Net assets @ doa		
\$1 Equity shares		120,000
Retained earnings		<u>275,000</u>
		395,000
Goodwill		<u>(77,000)</u>

Pup calculation

Asset cost		200,000
Acc dep		<u>120,000</u>
		80,000
Sold for		90,000
Pup of 10,000		
Dep for 2009		<u>40,000</u>
∴ excess dep is		<u>5,000</u>

W3 Consolidated retained earnings

	Linus	Asta
Per question	500,000	600,000
Less pup	(10,000)	
Excess depreciation	<u>5,000</u>	
	495,000	
Less pre acq		(275,000)
∴ post acq		<u>325,000</u>
Linus's share	<u>195,000</u>	60%
	690,000	
Plus goodwill	<u>77,000</u>	
	<u>767,000</u>	

W4 NC Interest (40%)

Value @ doa	158,000
Share of S post acq ret'd 40% x 325,000	<u>130,000</u>
	<u>288,000</u>



Answers to Examples

ANSWER TO EXAMPLE 4

Laimonas Group Consolidated Statement of Financial Position

		\$
INCA	(W2)	1,100
TNCA	(23 + 16)	39,000
Current assets	(36 + 64)	<u>100,000</u>
		<u>140,100</u>
\$1 Equity shares	L Only	60,000
Retained earnings	(W3)	38,040
NC Interest	(W4)	<u>6,060</u>
		104,100
Current liabilities	(9 + 10)	19,000
NCI prop div.		1,000
Proposed dividend	(for L)	<u>16,000</u>
		<u>140,100</u>
W1 L		
90%		
K — 10%		
W2 Goodwill		
Cost of investment		50,000
Nci investment valuation		<u>5,500</u>
		55,500
Net assets @ doa		
\$1 Equity shares		20,000
Retained earnings		<u>30,000</u>
		50,000
Goodwill		5,500
Impaired since acquisition 80% x 5,500		<u>(4,400)</u>
CS of FP		<u>1,100</u>
W3 Consolidated retained earnings		
per q	Laimonas	40,000
divs pble	Kristine	50,000
divs rble		<u>(16,000)</u>
		(10,000)
		<u>9,000</u>
		—
		33,000
less pre acq		40,000
∴ post acq		<u>30,000</u>
Laimonas' share		<u>9,000</u>
		90%
		42,000
Less: L's share of goodwill impairment 90% x 4,400		<u>(3,960)</u>
		<u>38,040</u>
W4 NC Interest (10%)		
Value at doa		5,500
Share of S post acq ret'd 10% x 10,000		<u>1,000</u>
		6,500
Less goodwill impairment 10% x 4,400		<u>(440)</u>
on CSFP		<u>6,060</u>



Chapter 9

ANSWER TO EXAMPLE 1

Ausra Group Consolidated Statement of Financial Position as at 31 October, 2011.

		\$
INCA (W2)		37,500
TNCA (260 + 200 – 27)		433,000
		470,500
Inventory (100 + 50 – 5.85)	144,150	
Receivables (90 + 80 – 6.5 + 1.8 – 1.8 – 11.5)	152,000	
Cash (5 + 6.5 + 36)	47,500	
		343,650
		814,150
\$1 Equity shares (100 + 20)		120,000
Share premium 30 + (20 × 3.30)		96,000
Retained earnings (W3)		194,275
NC Interest (W4)		43,025
		453,300
3% Debentures (30 + 80)	110,000	
Deferred cash (30 + 3 – 1.25)	31,750	
		141,750
		595,050
Current Liabilities		
Creditors (116 + 102 – 11.5)	206,500	
Dividend payable	12,000	
NCI prop div	600	
		219,100
		814,150

	A	5m pre	7m post		
W1					
	75%				
	D — 25%				
	Profit split for Danute profit for the year per question				60,000
	– profit on TNCA transfer				(36,000)
	Normal profits				24,000
	Split 5 : 7				
			10,000	14,000	
	TNCA transfer profit				– 36,000
			10,000	50,000	
	Inventory fair value adjustment				12,000 (12,000)
			22,000	38,000	38,000



Answers to Examples

W2 Goodwill	
Cost of acquisition	
Share capital $75\% \times 40,000 \times \frac{2}{3} \times 1 \times \4.30	86,000
Deferred cash payment $75\% \times 40,000 \times \frac{2}{2} \times \$1.21 \times 1/1.10 \times 1/1.10$	30,000
Cash payment $75\% \times 40,000 \times 2 \times \0.60	36,000
Value of nci investment $25\% \times 40,000 \times 2 \times \2.20	44,000
	<u>196,000</u>

Fair value of SNA @ DOA	
Share capital	40,000
Share premium	20,000
retained earnings brought forward	64,000
retained earnings 5 months	<u>22,000</u>
	146,000
Goodwill	5,000
Impaired since acquisition 25%	(12,500)
	<u><u>37,500</u></u>

#2 Pup on TNCA

Profit recognised by Danute	36,000
Depreciation on TNCA unrealised profit	(9,000)
	<u>27,000</u> Pup in Danute

#3 Pup on Inventory

Cost	+	profit	=	selling price
		30%	=	100%
profit element in closing inventory is $\therefore 30\%$				
$30\% \times 26,000 \times \frac{3}{4}$				
5,850 in Ausra				

#4 In Ausra	↑ Cash	6,500
	↓ Receivables	6,500

and then cancel \$11,500 receivables in Ausra against \$11,500 payables in Danute

#7 Dividends

In Ausra	$120,000 \times 10c$	dividend payable
In Danute	$40,000 \times 2 \times 3c$	2,400 dividend payable
of which Ausra wants to receive 75% ie		1,800 dividend receivable

and now cancel 1,800 receivable by Ausra against 1,800 of the 2,400 payable by Danute

#8 Nci investment

$25\% \times 40,000 \times 2 \times \2.20	<u>\$44,000</u>
---	-----------------



Answers to Examples

ACCA F7 March-June'18 Examinations

W3 Consolidated Retained Earnings

per question	Ausra	Danute
pup on TNCA	215,000	124,000
pup on Inventory		(27,000)
unrolled discount on deferred consideration	(5,850)	
dividends payable	(1,750)	
dividends receivable	(12,000)	(2,400)
	1,800	
	197,200	94,600
– pre acquisition		(86,000)
∴ Post-acquisition		<u>8,600</u>
our share		75%
	<u>6,450</u>	
	203,650	
Less goodwill impairment (just our share 75% × 12,500)	(9,375)	
	<u><u>194,275</u></u>	

W4 Non controlling interest

Value at date of acquisition	44,000
Share of post acquisition retained 25% × 8,600	<u>2,150</u>
	46,150
– Share of goodwill impairment since acquisition 25% × 12,500	(3,125)
	<u><u>43,025</u></u>

Chapter 10

ANSWER TO EXAMPLE 1

Mantas Group Consolidated Statement of Profit or Loss and Other Comprehensive Income for the year ended 31 December, 2009.

		\$
Revenue	(26 + 12)	38,000
Cost of sales and expenses	(10 + 7)	<u>17,000</u>
Profit before tax		21,000
Income tax expense	(6 + 1.5)	<u>7,500</u>
Profit after tax		13,500 *
NCI 20% × 3,500		<u>(700)</u>
		12,800
Dividend Mantas only		<u>5,000</u>
		<u><u>7,800</u></u>
Proof		
M own		7,000
+		
M's share of R's post acq ret'd 80% × 1,000		<u>800</u>
		<u><u>7,800</u></u>

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



Answers to Examples

ANSWER TO EXAMPLE 2

Lina Group Consolidated Statement of Profit or Loss and Other Comprehensive Income for the year ended 31 December, 2009.

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

* 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 Profit or Loss and Other 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)	<u>49,867</u>
Profit before tax		51,133
Income tax expense	(10 + 7)	17,000
Profit after tax		<u><u>34,133</u></u> *

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

Working

Pup on inventory

Cost	+	Profit	=	Selling Price
60	+	40	=	100

So profit on the transfer was $40\% \times 14,000 = 5,600$

One third is still in inventory

So we need a pup of $\frac{1}{3} \times 5,600$ in Karolis' Statement of Profit or Loss and Other 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 Profit or Loss and Other 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)	<u>44,700</u>
Profit before tax		115,300
Taxation	(20 + 18)	38,000
Profit after tax		<u><u>77,300</u></u> *

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

ANSWER TO EXAMPLE 5

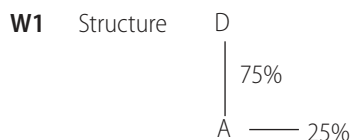
Didzis Group Consolidated Statement of Profit or Loss and Other Comprehensive Income for the year ended 30 June, 2009.

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

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



Answers to Examples



W2 Goodwill

Cost of investment	65,000
Nci investment valuation	<u>9,500</u>
	74,500

Net assets @ doa	
\$1 Equity shares	20,000
Retained earnings	<u>18,000</u>
	38,000

Goodwill	36,500
Impaired b/f	<u>(27,375)</u>
Impaired this year	<u>9,125</u>

W3a Retained earnings brought forward

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

W3b Retained earnings carried forward

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

W4a Nci (25%) brought forward

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

W4 Nci (25%)

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

W4b NC interest (25%)

A's profit after tax	<u>12,000</u>
NC Interest share 25% x 12,000	<u>3,000</u>



Answers to Examples

ANSWER TO EXAMPLE 6**Lasma Group Consolidated Statement of Profit or Loss and Other 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	<u>9,158.3</u>
Profit before tax		8,133.4
Income tax expense	2,000 + 7/12 × 420	<u>2,245</u>
Profit after tax		<u><u>5,888.4</u></u> *

* 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.

ANSWER TO EXAMPLE 7**Consolidated Statement of Financial Position**

Receivable	400,000
Other net assets	<u>750,000</u>
	<u>1,150,000</u>
\$1 equity shares	500,000
Retained earnings (W3)	635,000
nci	<u>—</u>
	1,135,000
tax payable	<u>15,000</u>
	<u><u>1,150,000</u></u>

Consolidated Statement of Profit or Loss and Other Comprehensive Income

profit before tax	170,000
gain / (loss) on disposal	<u>(137,500)</u>
	32,500
tax 30 + 21 + 15	<u>(66,000)</u>
	<u><u>(33,500)</u></u>

Consolidated Statement of Changes in Equity

	Shares	Ret Earnings	NCI	Total
brought forward	500,000	680,750	162,750	1,343,500
for the year		(33,500)	—	(33,500)
non-controlling interest		(12,250)	12,250	—
on disposal			<u>(175,000)</u>	<u>(175,000)</u>
	<u>500,000</u>	<u>635,000</u>	<u>—</u>	<u><u>1,135,000</u></u>

W1
D full year
75%
L ——— 25%

W2 Goodwill	
Cost of investment	350,000
Nci investment valuation 25% × 450,000	<u>112,500</u>
	462,500
NA @ doa	
\$1 equity shares	300,000
Retained earnings	<u>150,000</u>
Our share	450,000
	<u><u>12,500</u></u>
	all sold



Answers to Examples

ACCA F7 March-June'18 Examinations

W3A	Gain in parent proceeds		400,000
	Carrying value sold		<u>350,000</u>
			50,000
	Tax @ 30%		<u>15,000</u>
			<u>35,000</u>
W3B	Gain in group		
	Sale proceeds		400,000
	NA @ DOD		
	\$1 equity shares	300,000	
	Retained earnings	<u>400,000</u>	
		<u>700,000</u>	
	sold	75%	<u>525,000</u>
			(125,000)
	Goodwill sold		<u>(12,500)</u>
			(137,500)
	tax		<u>(15,000)</u>
	(loss) in Group		<u>(152,500)</u>
W3 b/f	Consolidated retained earnings per question	D	L
	- pre acquisition	530,000	351,000
	∴ post acq		<u>150,000</u>
	D's share	<u>150,750</u>	<u>201,000</u>
		<u>680,750</u>	75%
W3 c/f		D	
	per question	600,000	
	gain on disposal	<u>35,000</u>	
		<u>635,000</u>	
W4A b/f	nci (25%)		
	Value @ doa		112,500
	Share of post acq ret'd b/f		
	$25\% \times (400,000 - 150,000 - 49,000)$		
	$25\% \times 201,000$		<u>50,250</u>
			<u>162,750</u>
W4B	nci (25%)		
	$25\% \times 49,000$		<u>12,250</u>



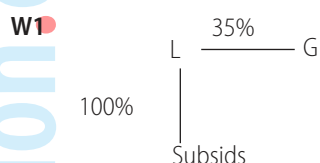
Answers to Examples

Chapter 11

ANSWER TO EXAMPLE 1

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

	\$
Investment in Associate (W5)	9,250
Other assets	180,000
Total assets	<u>189,250</u>
\$1 Equity shares	70,000
Retained earnings (W3)	104,250
	<u>174,250</u>
Liabilities	15,000
	<u>189,250</u>

**W3** Consolidated retained earnings

per question
– pre acq
∴ post acq
L's share

	<i>Laura</i>	<i>Gunta</i>
	99,000	18,000
		(3,000)
		<u>15,000</u>
	5,250	35%
	<u>104,250</u>	

W5A Investment in Associate

Cost
Share of post acq ret'd 35% (18 – 3)

4,000
5,250
<u>9,250</u>

ANSWER TO EXAMPLE 2

Maris Group Consolidated Statement of Profit or Loss and Other 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	<u>4,554</u>

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)
	<u>?</u>

or

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

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 Profit or Loss and Other Comprehensive Income

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

Statement of Financial Position

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



Answers to Examples**ANSWER TO EXAMPLE 3****Statement of Profit or Loss and Other Comprehensive Income**

	\$
Revenue recognised $60\% \times 1,200,000$	720,000
Costs recognised – period specific	200,000
– general ($60\% \times 850,000$)	510,000
	<u>(710,000)</u>
Profit recognised	<u>10,000</u>

Statement of Financial Position

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

ANSWER TO EXAMPLE 4**Statement of Profit or Loss and Other Comprehensive Income**

		\$
Revenue recognised	(65% \times 500,000)	325,000
Costs recognised (balancing figure)		(375,000)
Loss recognised		<u>(50,000)</u>

Statement of Financial Position

Costs to date		300,000
Attributable loss (from above)		(50,000)
		<u>250,000</u>
Amounts invoiced		(270,000)
Amounts due to customers		<u>(20,000)</u>
Amounts invoiced		270,000
Amounts received		(240,000)
Amounts due from customers (Accounts Receivable)		<u>30,000</u>



Answers to Examples

ACCA F7 March-June'18 Examinations

ANSWER TO EXAMPLE 5

Statement of Profit or Loss and Other Comprehensive Income

	<i>Year 1</i>	<i>Year 2</i>	<i>Year 3</i>
	\$	\$	\$
Revenue recognised	300,000	350,000	550,000
Costs recognised	(280,000)	(510,000)	(200,000)
Profit/(Loss) recognised	<u>20,000</u>	<u>(160,000)</u>	<u>350,000</u>

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 Profit or Loss and Other Comprehensive Income

	<i>Year 1</i>	<i>Year 2</i>	<i>Year 3</i>
	\$	\$	\$
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	<u>20,000</u>	<u>(140,000)</u>	<u>210,000</u>

Statement of Financial Position

Costs to date	340,000	540,000	990,000
Attributable profit (from above)	<u>20,000</u>	<u>(140,000)</u>	<u>210,000</u>
	360,000	400,000	1,200,000
Less amounts invoiced	390,000	610,000	1,150,000
Amounts due from/(to) customers	<u>(30,000)</u>	<u>(210,000)</u>	<u>50,000</u>

Amounts invoiced	390,000	610,000	1,150,000
Amounts received	<u>400,000</u>	<u>630,000</u>	<u>1,100,000</u>
	<u>(10,000)</u>	<u>(20,000)</u>	<u>50,000</u>

For the Statement of Profit or Loss and Other 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



Answers to 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 $2 \times 900 \times \$7$	12,600	$2 \times 900 \times \$7$	12,600	$2 \times \$700$	1,400
	Labour cost $2 \times 900/3 \times \$4$	<u>2,400</u>				
		15,000				
	Sell 2×300 dresses $\times \$22$	<u>13,200</u>	Sell $2 \times 900 \times \$6.25$	<u>11,250</u>		
	Loss	<u>(1,800)</u>	Loss	<u>(1,350)</u>	Loss	<u>(1,400)</u>

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 Profit or Loss and Other 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 Profit or Loss and Other 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.

Chapter 16

No EXAMPLES



Answers to Examples

ACCA F7 March-June'18 Examinations

Chapter 17**ANSWER TO EXAMPLE 1**

<i>Date</i>	<i>Cumulative Borrowing \$M</i>	<i>Invested \$M</i>	<i>Spent \$M</i>
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	$100 \times \frac{3}{12} \times 0.07$	1,750,000	
April to August	$220 \times \frac{5}{12} \times 0.07$	6,416,666	
September to October	$300 \times \frac{2}{12} \times 0.07$	3,500,000	
January to February	$300 \times \frac{2}{12} \times 0.07$	<u>3,500,000</u>	
			15,166,666
Investment income			
January to February	$50 \times \frac{2}{12} \times 0.05$	416,666	
March	$20 \times \frac{1}{12} \times 0.05$	83,333	
April to May	$90 \times \frac{2}{12} \times 0.05$	750,000	
June to August	$30 \times \frac{3}{12} \times 0.05$	375,000	
September to October	$90 \times \frac{2}{12} \times 0.05$	<u>750,000</u>	
			<u>2,375,000</u>
Capitalised borrowing costs			<u>12,791,666</u>
Carrying value immediately before sale			<u><u>\$312,791,666</u></u>

Chapter 18**ANSWER TO EXAMPLE 1**

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



Answers to Examples

ANSWER TO EXAMPLE 2

	2009	2010	2011	Total
	\$	\$	\$	\$
Profit before depreciation	1,800,000	2,300,000	2,500,000	6,600,000
Depreciation	<u>(200,000)</u>	<u>(200,000)</u>	<u>(200,000)</u>	<u>(600,000)</u>
Profit	1,600,000	2,100,000	2,300,000	6,000,000
Tax – current (W1)	300,000	575,000	625,000	1,500,000
– deferred (W2)	<u>100,000</u>	<u>(50,000)</u>	<u>(50,000)</u>	<u>-</u>
	<u>1,200,000</u>	<u>1,575,000</u>	<u>1,725,000</u>	<u>4,500,000</u>
Deferred tax liability	<u>100,000</u>	<u>50,000</u>	<u>-</u>	

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	<u>600,000</u>	<u>-</u>	<u>-</u>
	<u>1,200,000</u>	<u>2,300,000</u>	<u>2,500,000</u>
At 25%	<u>300,000</u>	<u>575,000</u>	<u>625,000</u>

(W2) Deferred tax working

Book value	400,000	200,000	-
Tax written down value	<u>-</u>	<u>-</u>	<u>-</u>
	<u>400,000</u>	<u>200,000</u>	<u>-</u>
At 25%	<u>100,000</u>	<u>50,000</u>	<u>-</u>

ANSWER TO EXAMPLE 3

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

ANSWER TO EXAMPLE 4

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

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

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

<i>PPE Acc Dep A/c</i>			
		b/f	390
Disposals	70		
c/f	520	Therefore dep.	200
	<u>590</u>		<u>590</u>

<i>Disposals A/c</i>			
Cost of disposals	110	Dep on disposals	70
		Proceeds	47
∴ Gain on disposals	7		
	<u>117</u>		<u>117</u>

Schedules

Cost

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

Depreciation

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

Disposal

Net book value disposed of	40,000
Proceeds	<u>47,000</u>
Therefore profit on disposal	<u>7,000</u>

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



Answers to Examples

ANSWER TO EXAMPLE 2

<i>Share Capital A/c</i>			
		b/f	35,000
		Bonus	5,000
c/f	58,000	Therefore new issue	18,000
	<u>58,000</u>		<u>58,000</u>

<i>Share Premium A/c</i>			
		b/f	17,600
c/f	29,700	Therefore new issue	12,100
	<u>29,700</u>		<u>29,700</u>

Schedules

Share capital

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

Share premium

Brought forward	17,600
Carried forward	29,700
Therefore premium on new issue	<u>12,100</u>

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

ANSWER TO EXAMPLE 3

<i>Int Payable A/c</i>			
Therefore cash	273,000	b/f	74,000
c/f	18,000	SOCI	217,000
	<u>291,000</u>		<u>291,000</u>

Obligations under finance leases A/c

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

Finance lease interest A/c

Transfer from Obligations a/c	<u>1,800</u>	SOCI	<u>1,800</u>
-------------------------------	--------------	------	--------------



Answers to Examples

ACCA F7 March-June'18 Examinations

Schedules

Interest

Int liability b/f	74,000
Statement of Profit or Loss and Other Comprehensive Income - interest for the year	<u>217,000</u>
	291,000
less liability c/f	<u>18,000</u>
Therefore paid	<u><u>273,000</u></u>

Obligations

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

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

		<i>Taxation A/c</i>	
Therefore paid	430	b/f	420
		SOCI	400
c/f	<u>390</u>		
	<u><u>820</u></u>		<u><u>820</u></u>

Schedules

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

ANSWER TO EXAMPLE 5

		Dividend payable A/c	
paid	831	b/f	831
paid	600	SOCI	1,515
c/f	<u>915</u>		
	<u><u>2,346</u></u>		<u><u>2,346</u></u>

Schedule

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



Answers to Examples

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		<u>955</u>
Decrease in inventory	82	
Increase in receivables	(92)	
Decrease in payables	<u>(12)</u>	
Cash generated from operations		<u>933</u>
Interest paid	(40)	
Dividend paid	(140)	
Taxation paid	<u>(228)</u>	
Net cash flow from operating activities		<u>(408)</u>
		525
Cash flows from investing activities		
Purchase of TNCA	(200)	
Purchase of INCA	(641)	
Proceeds of asset disposal	103	
Purchase of investments	<u>(239)</u>	
Net cash flow from investing activities		<u>(977)</u>
		(452)
Cash flows from financing activities		
Proceeds of share issue (125 + 103)	228	
Proceeds of debenture issue	<u>132</u>	
Net cash flow from financing activities		<u>360</u>
Net decrease in cash and cash equivalents		(92)
Cash and cash equivalents at start of the year		<u>81</u>
Cash and cash equivalents at end of the year (17 + 32 – 60)		<u><u>(11)</u></u>

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 \$'000	2008 \$'000
Cash in hand and balances with banks	17	81
Investment in Treasury Bills	<u>32</u>	<u>–</u>
Cash and cash equivalents	<u><u>49</u></u>	<u><u>81</u></u>



Answers to Examples

ACCA F7 March-June'18 Examinations

ANSWER TO EXAMPLE 7

(a) Indirect method

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

(b) Direct method

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

Workings**W1** Cash received from customers**Receivables A/c**

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

Schedule

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

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	<u>?</u>
	2,395
Less closing inventory	<u>(647)</u>
Cost of sales	<u><u>1,748</u></u>
Purchases of goods is therefore	<u><u>1,877</u></u>

Payables A/c

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



Answers to Examples

Schedule

b/f	401
Increased by goods purchased	1,877
Admin costs	108
Distribution costs	438
	<u>2,824</u>
c/f	(329)
	<u><u>2,495</u></u>

W3 Administrative expenses

per Q	317	
less depreciation	<u>84</u>	not cash
	233	
less employee costs	<u>123</u>	shown separately
	110	
less bad debts w/o	<u>17</u>	not cash
	93	
add back profit on asset disposal	<u>15</u>	not cash
	<u><u>108</u></u>	

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.



Answers to Examples

ACCA F7 March-June'18 Examinations

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 and Liquidity

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 $6\frac{1}{2}$ months. (2008 104 days, $3\frac{1}{2}$ 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 Profit or Loss and Other 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.



Answers to Examples

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

Chapter 21

ANSWER TO EXAMPLE 1

Rights fraction

	Shares	Value	Investment
Before	4	4	16
Rights	1	3	3
After	<u>5</u>		<u>19</u>

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		<u>2,604,166</u>
				<u>5,674,341</u>

$$\text{EPS} = \frac{3,000,000}{5,674,341} = 52.9\text{c}$$

2008 as originally disclosed 54c

$$\text{as restated} = \frac{54 \times 3.8}{4} = 51.3\text{c}$$



Answers to Examples

ACCA F7 March-June'18 Examinations

ANSWER TO EXAMPLE 2

Date	Number	Period	Fraction	WAVES
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
				<u>4,500,000</u>

$$\text{Basic EPS} = \frac{600,000}{4,500,000} = 13.3c$$

Last year, as originally disclosed 16c
as restated 12.4c

ANSWER TO EXAMPLE 3

$$\text{Basic EPS} = \frac{2,800,000}{4,000,000} = 70c$$

Diluted

	3,000,000	@ 4	12,000,000
	2,400,000	@ 5	12,000,000
Therefore	<u>600,000</u>	@ 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	<u>4,600,000</u>	<u>2,800,000</u>
So diluted EPS is	$\frac{2,800,000}{4,600,000}$	= 60.9c

ANSWER TO EXAMPLE 4

$$\text{Basic} = \frac{700,000}{2,000,000} = 35 \text{ basic eps}$$

Diluted

Potential equity shares (the worst position)

$$\frac{3,000,000}{1,000} \times 760 = 2,280,000 \text{ Pes}$$

Potential extra earnings

$$3,000,000 \times 6.25\% \times .75 = \$140,625 \text{ Pee}$$

$$\text{Diluted calculation} = \frac{700,000 + 140,625}{2,000,000 + 2,280,000} = 19.64c$$

ANSWER TO EXAMPLE 5

$$\text{Basic eps} = \frac{10,000,000}{3,370,000} = \$2.97$$

Dilution workings

520,000 options

520,000	@ 3	1,560,000
390,000	@ 4	1,560,000
<u>130,000</u>	free Pes and no Pee	

2,000,000 options



Answers to Examples

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

$$\text{Pes} \quad \frac{20,000,000}{1,000} \times 30 = 600,000 \quad \text{Pes}$$

$$\text{Pee} \quad 10.673\% \times 20,000,000 \times .75 = \$1,600,950 \text{ Pee}$$

	<i>Pes</i>	<i>Pee</i>	<i>Meps</i>	<i>Rank</i>
Options	130,000	—	—	①
Bonds	600,000	1,600,950	2.67	②

Working to find diluting instruments

	<i>shares</i>	<i>earnings</i>	<i>Eps</i>
	3,370,000	9,100,000	\$2.70 control figure
options	<u>130,000</u>	<u>—</u>	
	3,500,000	9,100,000	\$2.60
bonds	<u>600,000</u>	<u>1,600,950</u>	
	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

	<i>shares</i>	<i>earnings</i>	<i>Eps</i>
existing	3,370,000	10,000,000	
options	<u>130,000</u>	<u>—</u>	
	3,500,000	10,000,000	\$2.86

The disclosed diluted eps will therefore be \$2.86

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****No EXAMPLES**

Chapter 29

ANSWER TO EXAMPLE 1

(a) IAS 41 states that an entity should recognise agricultural produce or a biological asset when the following characteristics apply:

- the entity controls the asset as a result of past events and
- it is probable that future economic benefits associated with the asset will flow to the entity and
- the fair value or cost of the asset can be reliably measured

These are the same characteristics that apply to any asset to be recognised

Agricultural produce and biological assets are normally measured at fair value less estimated costs of sale

It is assumed that the fair value of agricultural produce and biological assets can be measured reliably.

That presumption can only be rebutted for agricultural produce and biological assets where market prices or values are not available and alternative measures of fair value are 'clearly unreliable'.

Such rebuttal must be made on initial recognition of the asset.

Historic cost is the most frequently used basis for reliable measurement

In the context of measuring the value of many assets, historic cost is appropriate but in the context of biological assets (for example newly born livestock) the concept of 'cost' is not an easy one to apply and so fair value could well be more appropriate.

(b) Extracts from the statement of profit or loss

	\$'000	\$'000
Income		
Change in fair value of purchased herd (W2)	(70.50)	
Government grant (W3)	940.00	
Change in fair value of newly born calves (W4)	290.75	
Fair value of milk (W5)	<u>12.90</u>	
Total income		1,173.15
Expense		
Maintenance costs (W2)	1,175.00	
Breeding fees (W2)	<u>705.00</u>	
Total expense		<u>(1,880.00)</u>
Net deficit		<u>(706.85)</u>

Extracts from the statement of financial position

Property, plant and equipment:		
Land (W1)	47,000.00	
Mature herd (W2)	2,279.50	
Calves (W4)	<u>290.75</u>	
		49,570.25
Inventory		
Milk (W5)		12.90



Answers to Examples

Workings

W1 Land

Land is not an asset to which IAS 41 is applied – the relevant standard is IAS 16 – Property, Plant and Equipment

Land would be recorded at cost on initial acquisition and is not normally subjected to depreciation

Under the benchmark treatment laid down in IAS 16 no recognition would be made of post-acquisition changes in the value of the land unless the class of asset is treated on a revaluation basis with surpluses taken to a Revaluation Reserve

W2 Cows

Under the 'fair value model' laid down in IAS 41 the mature cows would be recognised in the balance sheet at 30 September, 2013 at their fair value of $10,000 \times \$227.95 = \$2,279,500$

The difference between the fair value of the mature herd and its cost ($\$2,279,500 - \$2,350,000 =$ a loss of $\$70,500$) would be charged in the statement of profit or loss, as also will the maintenance costs of $\$1,175,000$

W3 Grant

Grants relating to agricultural activity are not subject to the normal requirement of IAS 20 Government Grants in that they are not credited to the statement of profit or loss over a period of time

Instead, under IAS 41, government agricultural grants are credited to income as soon as they are unconditionally receivable rather than being recognised over the useful economic life of the asset to which they relate

Therefore $\$940,000$ would be credited to income by Numbers

W4 Calves

The calves are a biological asset and the fair value model is applied

The breeding fees of $\$705,000$ are charged to income and an asset of $5,000 \times \$58.15 = \$290,750$ recognised in the statement of financial position and credited to income in the statement of profit or loss

W5 Milk

Milk is agricultural produce and is initially recognised on the same basis as biological assets

Thus the milk would be valued at $10,000 \times \$1.29 = \$12,900$

In the context of IAS 2 Inventories, this figure is taken to be 'cost' for the unsold milk

Chapter 30

ANSWER TO EXAMPLE 1

19 December, 2015

Dr Purchases	116,453
Cr Payables (Mainwaring) (80,000 / 0.7)	114,286
Cr Payables (Cholmondley) (20,000 / 9.23)	2,167

31 December, 2015

Dr Payables (Cholmondley) (20,000 / 9.3) - (20,000 / 9.23)	16
Cr Exchange difference	16

3 February, 2016

Dr Payables (Mainwaring)	114,286
Dr Payables (Cholmondley) (20,000 / 9.0)	2,222
Cr Cash	116,508

The balance remaining on the Payables (Cholmondley) Account is a $\$71$ debit balance and, if there is no transaction with Cholmondley in 2016, the debit balance will be expensed to statement of profit or loss at the end of 2016





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?



Mini Exercises – Questions**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
- 11 After the acquisition, P sold goods to S for \$15 million on which P made a gross profit of 20%. S had one third of these goods still in its inventory at 30 September 2009. There are no intra-group current account balances at 30 September 2009.



Mini Exercises – Questions

- 12** At 31 March 2010 P's current account with S was \$3.4 million (debit). This did not agree with the equivalent balance in S's books due to some goods-in-transit invoiced at \$1.8 million that were sent by P on 28 March 2010, but had not been received by S until after the year end. P sold all these goods at cost plus 50%.
- 13** After the acquisition S sold goods to P for \$40 million. These goods had cost S \$30 million. \$12 million of the goods sold remained in P's closing inventory.
- 14** At 30 September 2011, S's inventory included goods bought from P (at cost to S) of \$2.6 million. P had marked up these goods by 30% on cost. P's agreed current account balance owed by S at 30 September 2011 was \$1.3 million.
- 15** P sells goods to S at cost plus 50%. Below is a summary of the recorded activities for the year ended 31 March 2012 and balances as at 31 March 2012:

P Sales to S	S Purchases from P
\$'000	\$'000
16,000	4,400
Included in P's receivables	Included in S's payables
14,500	1,700

On 26 March 2012, P sold and despatched goods to S, which S did not record until they were received on 2 April 2012. S's inventory was counted on 31 March 2012 and does not include any goods purchased from P.

On 27 March 2012, S remitted to P a cash payment which was not received by P until 4 April 2012. This payment accounted for the remaining difference on the current accounts.

- 16** Sales from P to S throughout the year ended 30 September 2012 had consistently been \$800,000 per month. P made a mark-up on cost of 25% on these sales. S had \$1.5 million of these goods in inventory as at 30 September 2012
- 17** Each month since acquisition, P's sales to S were consistently \$4.6 million. P had marked these up by 15% on cost. S had one month's supply (\$4.6 million) of these goods in inventory at 31 March 2013. P's normal mark-up (to third party customers) is 40%
- 18** P transferred raw materials at their cost of \$4 million to S in June 2013. S processed all of these materials incurring additional direct costs of \$1.4 million and sold them back to P in August 2013 for \$9 million. At 30 September 2013 P had \$1.5 million of these goods still in inventory. There were no other intra-group sales
- 19** After the acquisition P sold goods to S for \$20 million. S had one fifth of these goods still in inventory at 31 March 2014. All sales to S had a mark-up on cost of 25%.
- 20** Sales from P to S were at a mark up of 25% on cost. At the year end S still had \$600,000 worth of these goods in inventory (at cost to S)



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:

- the directors have valued the investment of the nci in the shares of S at \$380,000
- the value of the S shares immediately before the H acquisition was \$1.60
- 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:

- the directors have valued the investment of the nci in the shares of S at \$310,000
- the value of the S shares immediately before the H acquisition was \$1.58
- 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:

- the directors have valued the investment of the nci in the shares of S at \$110,000
- the value of the S shares immediately before the H acquisition was 70c
- 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**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:-

- the directors have valued the investment of the nci in the shares of S at \$305,000
- the value of the S shares immediately before the H acquisition was \$1.50
- the directors valued the goodwill attributable to the nci at \$15,000
- 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:-

- the directors have valued the investment of the nci in the shares of S at \$340,000
- the value of the S shares immediately before the H acquisition was \$1.20
- the directors valued the goodwill attributable to the nci at \$10,000
- 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:-

- the directors have valued the investment of the nci in the shares of S at \$85,000
- the value of the S shares immediately before the H acquisition was 40c
- the directors valued the goodwill attributable to the nci at \$13,000
- 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.

Question 3

Immediately after the acquisition of the subsidiary on 1 October 2010, P transferred an item of plant with a carrying amount of \$4 million to S at an agreed value of \$5 million. At this date the plant had a remaining life of two and half years. P had included the profit on this transfer as a reduction in its depreciation costs. All depreciation is to be charged to cost of sales in the statement of profit or loss for the year ended 31 March, 2011

What adjustments are necessary on consolidation and identify in which company's records those adjustments should be?



Mini Exercises – Questions

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.

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 1 October, 2007	130,000
Plant at cost	128,000
Accumulated depreciation to 1 October, 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

ACCA F7 March-June'18 Examinations

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	12,500

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.



Mini Exercises – Questions

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 Statement of Profit or Loss 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.

Question 6

Extracts from trial balance at 30 September, 2009

Freehold property at cost 1.10.2000	63,000
Plant and equipment at cost	42,200
Brand at cost 1.10.2005	30,000
Accum depreciation 1.10.08 building	8,000
Accum depreciation 1.10.08 plant	19,700
Accum amortisation 1.10.08 brand	9,000

Prepare the workings for the non-current assets' depreciation, amortisation and impairment for inclusion within the 2009 financial statements as appropriate

The freehold property has a land element of \$13 million. The building element is being depreciated on a straight-line basis.

Plant and equipment is depreciated at 40% per annum using the reducing balance method.

The brand in the trial balance relates to a product line that received bad publicity during the year which led to falling sales revenues. An impairment review was conducted on 1 April 2009 which concluded that, based on estimated future sales, the brand had a value in use of \$12 million and a remaining life of only three years. However, on the same date as the impairment review, the company received an offer to purchase the brand for \$15 million. Prior to the impairment review, it was being depreciated using the straight-line method over a 10-year life.

No depreciation/amortisation has yet been charged on any non-current asset for the year ended 30 September 2009. Depreciation, amortisation and impairment charges are all charged to cost of sales.



Mini Exercises – Questions

ACCA F7 March-June'18 Examinations

Question 7

Extracts from trial balance at 31 March, 2010

Leasehold (15 years) property at cost	45,000	
Plant and equipment at cost	67,500	
Accum depreciation 1.04.09 property		6,000
Accum depreciation 1.04.09 plant		23,500

Prepare the workings for the non-current assets' depreciation, amortisation and impairment for inclusion within the 2010 financial statements as appropriate

In order to fund a new project, on 1 October 2009 the company decided to sell its leasehold property. From that date it commenced a short-term rental of an equivalent property. The leasehold property is being marketed by a property agent at a price of \$40 million, which was considered a reasonably achievable price at that date. The expected costs to sell have been agreed at \$500,000. Recent market transactions suggest that actual selling prices achieved for this type of property in the current market conditions are 15% less than the value at which they are marketed. At 31 March 2010 the property had not been sold.

Plant and equipment is depreciated at 15% per annum using the reducing balance method.

No depreciation/amortisation has yet been charged on any non-current asset for the year ended 31 March 2010. Depreciation, amortisation and impairment charges are all charged to cost of sales.

Question 8

Extracts from trial balance at 30 September, 2010

Land & buildings at valuation 30.09.09 (Land \$7m, Buildings \$36m)	43,000	
Plant and equipment at cost	67,400	
Accum depreciation 30.09.09 plant		13,400

Prepare the workings for the non-current assets' depreciation, amortisation and impairment for inclusion within the 2010 financial statements as appropriate

The company revalues its land and building at the end of each accounting year. At 30 September 2010 the relevant value to be incorporated into the financial statements is \$41.8 million. The building's remaining life at the beginning of the current year (1 October 2009) was 18 years. An annual transfer from the revaluation reserve to retained earnings in respect of the realisation of the revaluation surplus is not made. Ignore deferred tax on the revaluation surplus.

Plant and equipment includes an item of plant bought for \$10 million on 1 October 2009 that will have a 10-year life (using straight-line depreciation with no residual value). Production using this plant involves toxic chemicals which will cause decontamination costs to be incurred at the end of its life. The present value of these costs using a discount rate of 10% at 1 October 2009 was \$4 million. The company has not provided any amount for this future decontamination cost. All other plant and equipment is depreciated at 12.5% per annum using the reducing balance method.

No depreciation has yet been charged on any non-current asset for the year ended 30 September 2010. All depreciation is charged to cost of sales.



Mini Exercises – Questions**Question 9**

Extracts from trial balance at 31 March, 2011

Freehold property at cost (1 April, 2005)		
(Land \$25m, property \$50m)	75,000	
Plant and equipment at cost	74,500	
Accum depreciation 1.04.10 property		10,000
Accum depreciation 1.04.10 plant		24,500

Prepare the workings for the non-current assets' depreciation, amortisation and impairment for inclusion within the 2011 financial statements as appropriate

On 1 April 2010 the company decided for the first time to value its freehold property at its current value. A qualified property valuer reported that the market value of the freehold property on this date was \$80 million, of which \$30 million related to the land. At this date the remaining estimated life of the property was 20 years. The company does not make a transfer to retained earnings in respect of excess depreciation on the revaluation of its assets.

Plant is depreciated at 20% per annum on the reducing balance method.

All depreciation of non-current assets is charged to cost of sales.

Question 10

Extracts from trial balance at 30 September, 2011

Leasehold property at cost	50,000	
Plant and equipment at cost	44,500	
Accum amortisation property (1.10.10)		10,000
Accum depreciation plant (1.10.10)		14,500

Prepare the workings for the non-current assets' depreciation, amortisation and impairment for inclusion within the 2011 financial statements as appropriate

During the year the company manufactured an item of plant for its own use. The direct materials and labour were \$3 million and \$4 million respectively. Production overheads are 75% of direct labour cost and the company determines the final selling price for goods by adding a mark-up on total cost of 40%. These manufacturing costs are included in the relevant expense items in the trial balance. The plant was completed and put into immediate use on 1 April 2011.

All plant and equipment is depreciated at 20% per annum using the reducing balance method with time apportionment in the year of acquisition.

The directors decided to revalue the leased property in line with recent increases in market values. On 1 October 2010 an independent surveyor valued the leased property at \$48 million, which the directors have accepted. The leased property was being amortised over an original life of 20 years which has not changed. The company does not make a transfer to retained earnings in respect of excess amortisation. All depreciation and amortisation is charged to cost of sales. No depreciation or amortisation has yet been charged on any non-current asset for the year ended 30 September 2011.



Mini Exercises – Questions

ACCA F7 March-June'18 Examinations

Question 11

Extracts from trial balance at 31 March, 2012

Leased property (12 years) at cost	48,000	
Plant and equipment at cost	47,500	
Accum amortisation 1.04.11 property		16,000
Accum depreciation 1.04.11 plant		33,500

Prepare the workings for the non-current assets' depreciation, amortisation and impairment for inclusion within the 2011 financial statements as appropriate

To reflect a marked increase in property prices, the company decided to revalue its leased property on 1 April 2011. The Directors accepted the report of an independent surveyor who valued the leased property at \$36 million on that date. The company has not yet recorded the revaluation. The remaining life of the leased property is eight years at the date of the revaluation. The company makes an annual transfer to retained profits to reflect the realisation of the revaluation reserve. In the local tax jurisdiction the revaluation does not give rise to a deferred tax liability.

On 1 April 2011, the company acquired an item of plant under a finance lease agreement that had an implicit finance cost of 10% per annum. The lease payments in the trial balance represent an initial deposit of \$2 million paid on 1 April 2011 and the first annual rental of \$6 million paid on 31 March 2012. The lease agreement requires further annual payments of \$6 million on 31 March each year for the next four years. Had the plant not been leased it would have cost \$25 million to purchase for cash.

Plant and equipment (other than the leased plant) is depreciated at 20% per annum using the reducing balance method.

No depreciation/amortisation has yet been charged on any non-current asset for the year ended 31 March 2012. Depreciation and amortisation are charged to cost of sales.

Question 12

The company had been carrying land and buildings at depreciated cost, but due to a recent rise in property prices, it decided to revalue its property on 1 October, 2011 to market value. An independent valuer confirmed the value of the property at \$60 million (land element \$12 million) as at that date and the directors accepted this valuation. The property had a remaining life of 16 years at the date of its revaluation. A transfer from the revaluation reserve to retained earnings will be made in respect of the realisation of the revaluation reserve. Ignore deferred tax on the revaluation.

Plant and equipment is depreciated at 15% per annum using the reducing balance method.

No depreciation has yet been charged on any non-current asset for the year ended 30 September, 2012. All depreciation is charged to cost of sales.

Question 13

On 1 October, 2012, the company terminated the production of one of its product lines. From this date, the plant used to manufacture the product has been actively marketed at an advertised price of \$4.2 million which is considered realistic. It is included in the trial balance at a cost of \$9 million with accumulated depreciation (at 1 April 2012) of \$5 million.

On 1 April, 2012, the directors decided that the financial statements would show an improved position if the land and buildings were revalued to market value. At that date, an independent valuer valued the land at \$12 million and the buildings at \$35 million and these valuations were accepted by the directors. The remaining life of the buildings at that date was 14 years. A transfer to retained earnings for excess depreciation is not made. Ignore deferred tax on the revaluation surplus.

Plant and equipment is depreciated at 20% per annum using the reducing balance method and time apportioned as appropriate.

All depreciation is charged to cost of sales, but none has yet been charged on any non-current asset for the year ended 31 March, 2013.



Mini Exercises – Questions

Question 14

The directors decided to revalue the land and building, for the first time, on 1 October, 2012. A qualified valuer determined the relevant revalued amounts to be \$16 million for the land and \$38.4 million for the building. The building's remaining life at the date of the revaluation was 16 years. This revaluation has not yet been reflected in the trial balance figures. The company does not make a transfer from the revaluation reserve to retained earnings in respect of the realisation of the revaluation surplus. Deferred tax is applicable to the revaluation surplus at 25%.

The leased plant was acquired on 1 October, 2011 under a five-year finance lease which has an implicit interest rate of 10% per annum. The rentals are \$9.2 million per annum payable on 30 September each year.

Owned plant and equipment is depreciated at 12.5% per annum using the reducing balance method.

No depreciation has yet been charged on any non-current asset for the year ended 30 September, 2013. All depreciation is charged to cost of sales.



Mini Exercises – Questions

ACCA F7 March-June'18 Examinations

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.

Question 5

The company issued a \$25 million 6% loan note on 1 October, 2011. Issue costs were \$1 million and these have been charged to administrative expenses. The loan will be redeemed on 30 September, 2014 at a premium which gives an effective interest rate on the loan of 8%.

What finance charge will appear in the statement of profit or loss for the year ended 31 March, 2012

Question 6

The \$40 million loan note was issued at par on 1 October, 2012. No interest will be paid on the loan; however, it will be redeemed on 30 September, 2015 for \$53,240,000 which gives an effective finance cost of 10% per annum

What finance charge will appear in the statement of profit or loss for the year ended 31 March, 2013

Question 7

The \$50 million loan note was issued at par on 1 August 2013. No interest will be paid on the loan.

However, it will be redeemed on 31 July 2016 for \$62,985,600 which gives an effective finance cost of 8% per annum.

What finance charge will appear in the statement of profit or loss for the year ended 31 January, 2015?"



Mini Exercises – Questions

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 Statement of Profit or Loss.

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 Statement of Profit or Loss. 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 Statement of Profit or Loss. 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.

Question 6

Extracts from trial balance at 30 September, 2009

Current tax debit balance	2,100
Deferred tax liability	5,400

The balance on current tax represents the under/over provision of the tax liability for the year ended 30 September 2008. The directors have estimated the provision for income tax for the year ended 30 September 2009 at \$16.2 million. At 30 September 2009 the carrying amounts of the company's net assets were \$13 million in excess of their tax base. The income tax rate is 30%.



Mini Exercises – Questions

ACCA F7 March-June'18 Examinations

Question 7

Extracts from trial balance at 1 March, 2010

Current tax credit balance	1,400
Deferred tax liability	6,000

A provision for income tax for the year ended 31 March, 2010 of \$12 million is required. The balance on current tax represents the under/over provision of the tax liability for the year ended 31 March 2009. At 31 March, 2010 the tax base of the company's net assets was \$14 million less than their carrying amounts. The income tax rate is 30%.

Question 8

Extracts from trial balance at 30 September, 2010

Current tax debit balance	900
Deferred tax liability	4,000

A provision for income tax for the year ended 30 September, 2010 of \$5.6 million is required. The balance on current tax represents the under/over provision of the tax liability for the year ended 30 September, 2009. At 30 September, 2010 the tax base of the net assets was \$15 million less than their carrying amounts. The movement on deferred tax should be taken to the income statement. The income tax rate is 25%.

Question 9

Extracts from trial balance at 31 March, 2011

Current tax credit balance	800
Deferred tax liability	2,600

The balance on current tax represents the under/over provision of the tax liability for the year ended 31 March, 2010. The required provision for income tax for the year ended 31 March, 2011 is \$19.4 million. The difference between the carrying amounts of the net assets of the company and their (lower) tax base at 31 March, 2011 is \$27 million. The rate of income tax is 25%.

Question 10

Extract from trial balance at 30 September, 2011

Deferred tax liability	2,700
------------------------	-------

The directors decided to revalue the leased property in line with recent increases in market values. On 1 October, 2010 an independent surveyor valued the leased property at \$8 million higher than its carrying value, which the directors have accepted. The revaluation gain will create a deferred tax liability

A provision for income tax for the year ended 30 September, 2011 of \$24.3 million is required. At 30 September, 2011, the tax base of the company's net assets was \$15 million less than their carrying amounts. This excludes the effects of the revaluation of the leased property. The income tax rate is 30%.

Question 11

Extracts from trial balance at 31 March, 2012

Current tax debit balance	800
Deferred tax liability	3,200

The company's income tax calculation for the year ended 31 March, 2012 shows a tax refund of \$2.4 million. The balance on current tax in the trial balance represents the under/over provision of the tax liability for the year ended 31 March 2011. At 31 March, 2012, the company had taxable temporary differences of \$12 million (requiring a deferred tax liability). The income tax rate is 25%.

Question 12

Extracts from trial balance at 30 September, 2012

Current tax debit balance	1,100
Deferred tax liability	2,700

The balance on current tax represents the under/over provision of the tax liability for the year ended 30 September, 2011. A provision for income tax for the year ended 30 September, 2012 of \$7.4 million is required. At 30 September, 2012, there were taxable temporary differences of \$5 million, requiring a provision for deferred tax. Any deferred tax adjustment should be reported in the income statement. The income tax rate is 20%.



Mini Exercises – Questions**Question 13**

Extracts from trial balance at 31 March, 2013

Current tax credit balance	1,200
Deferred tax liability	6,200

The company estimates that an income tax provision of \$27.2 million is required for the year ended 31 March, 2013 and at that date the liability to deferred tax is \$9.4 million. The movement on deferred tax should be taken to profit or loss. The balance on current tax in the trial balance represents the under/over provision of the tax liability for the year ended 31 March, 2012

Question 14

Extracts from trial balance at 30 September, 2013

Current tax credit balance	1,050
Deferred tax liability	8,000

The company decided to revalue its land and building, for the first time, on 1 October, 2012. A qualified valuer determined the relevant revalued amounts to be \$4.4 million greater than the carrying values.

The company does not make a transfer from the revaluation reserve to retained earnings in respect of the realisation of the revaluation surplus. Deferred tax is applicable to the revaluation surplus at 25%

A provision for income tax for the year ended 30 September, 2013 of \$3.4 million is required. The balance on current tax represents the under/over provision of the tax liability for the year ended 30 September, 2012. At 30 September, 2013, the tax base of the company's net assets was \$24 million less than their carrying amounts. This does not include the effect of the revaluation in note (ii) above. The income tax rate is 25%

Question 15

Extracts from trial balance at 31 March, 2014

Current tax debit balance	3,200
Deferred tax liability	4,600

The balance on current tax represents the under/over provision of the tax liability for the year ended 31 March, 2013. A provision of \$28 million is required for current tax for the year ended 31 March, 2014 and at this date the deferred tax liability was assessed at \$8.3 million.

Question 16

Extracts from trial balance at 30 September, 2014

Current tax (credit balance)	1,100
Deferred tax liability	4,600

A provision of \$2.4 million is required for current income tax on the profit for the year to 30 September, 2014. The balance on Current Tax in the trial balance is the under / over provision for taxation for 2013.

Kandy has taxable temporary differences at 30 September, 2014 of \$22 million and the tax rate is 20%



Mini Exercises – Questions

ACCA F7 March-June'18 Examinations

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 Statement of Profit or Loss 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.



Mini Exercises – Questions

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:

	<i>\$'000</i>
material, labour and overheads	12,000
specialist plant acquired 1 October 2009	8,000
payment from customer	(5,700)
	<u>14,300</u>

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.

Question 8

The details of a construction contract are:

	costs to 31 March, 2010	further costs to complete
	\$'000	\$'000
materials	5,000	8,000
labour and other direct costs	<u>3,000</u>	<u>7,000</u>
	8,000	<u>15,000</u>
plant acquired at cost	<u>12,000</u>	
per trial balance	<u>20,000</u>	

The contract commenced on 1 October, 2009 and is scheduled to take 18 months to complete. The agreed contract price is fixed at \$40 million. Specialised plant was purchased at the start of the contract for \$12 million. It is expected to have a residual value of \$3 million at the end of the contract and should be depreciated using the straight-line method on a monthly basis. An independent surveyor has assessed that the contract is 30% complete at 31 March, 2010. The customer has not been invoiced for any progress payments. The outcome of the contract is deemed to be reasonably certain as at the year end. What amounts would be included within the financial statements for revenue, cost of sales, plant and amounts due from customers?



Mini Exercises – Questions

ACCA F7 March-June'18 Examinations

Question 9

It has been discovered that goods with a cost of \$6 million, which had been correctly included in the count of the inventory at 31 March, 2010, had been invoiced in April 2010 to customers at a gross profit of 25% on sales, but included in the revenue (and receivables) of the year ended 31 March, 2010. What adjustment is necessary (if any) to correct the above situation?

Question 10

On 31 March, 2011 the company factored (sold) trade receivables with a book value of \$10 million to Shark Limited. The company received an immediate payment of \$8.7 million and will pay Shark Limited 2% per month on any uncollected balances. Any of the factored receivables outstanding after six months will be refunded to Shark Limited. The company has derecognised the receivables and charged \$1.3 million to administrative expenses. If the company had not factored these receivables it would have made an allowance of \$600,000 against them. What adjustment (if any) is necessary to correct the situation outlined above?

Question 11

Extracts from trial balance at 31 March, 2011

Inventory at 4 April, 2011	36,000
----------------------------	--------

The inventory of the company was not counted until 4 April, 2011 due to operational reasons. At this date its value at cost was \$36 million and this figure has been used in the cost of sales calculation above. Between the year end of 31 March, 2011 and 4 April, 2011, a delivery of goods was received at a cost of \$2.7 million and sales of \$7.8 million at a mark-up on cost of 30% were made. Neither the goods delivered nor the sales made in this period were included in purchases (as part of cost of sales) or revenue in the above trial balance. Calculate the closing inventory as at 31 March, 2011

Question 12

Extracts from trial balance at 31 March, 2012

	\$
Equity shares of 50 cents each	45,000
Share premium	5,000
Suspense account (credit balance)	13,500

The suspense account represents the corresponding credit for cash received for a fully subscribed rights issue of equity shares made on 1 January, 2012. The terms of the share issue were one new share for every five held at a price of 75 cents each. The price of the company's equity shares immediately before the issue was \$1.20 each. What's the journal entry to correct and properly record the proceeds of the share issue and calculate the rights fraction that would be used in an earnings per share question



Mini Exercises – Questions

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 in 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 in 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 in excess of its carrying value. In addition, Sebastian owned a brand name, not recognised in 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.

	<i>Panda</i>	<i>Sloth</i>
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



Mini Exercises – Questions

ACCA F7 March-June'18 Examinations

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	<u>11,000</u>	<u>1,000</u>
	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.



Mini Exercises – Questions

Question 8

On 1 April, 2009 P purchased 80% of the equity shares in S. The acquisition was through a share exchange of three shares in P for every five shares in S. The market prices of P's and S's shares at 1 April, 2009 were \$6 per share and \$3.20 respectively.

The following information for the equity of the companies at 30 September, 2009 is available:

	P	S
Equity shares of \$1 each	200,000	120,000
Share premium	300,000	-
Retained earnings 1 October, 2008	40,000	152,000
Profit for the year ended 30 September, 2009	47,200	21,000

The fair values of the net assets of S at the date of acquisition were equal to their carrying amounts with the exception of an item of plant which had a carrying amount of \$12 million and a fair value of \$17 million. This plant had a remaining life of five years (straight-line depreciation) at the date of acquisition of S. All depreciation is charged to cost of sales.

In addition S owns the registration of a popular internet domain name. The registration, which had a negligible cost, has a five year remaining life (at the date of acquisition); however, it is renewable indefinitely at a nominal cost. At the date of acquisition the domain name was valued by a specialist company at \$20 million.

The fair values of the plant and the domain name have not been reflected in S's financial statements.

The non-controlling interest in S is to be valued at its (full) fair value at the date of acquisition. For this purpose S's share price at that date can be taken to be indicative of the fair value of the shareholding of the non-controlling interest

Immediately after acquisition P invested \$50 million in an 8% loan note issued by S

Question 9

On 1 October, 2010 P purchased 75% of the equity shares in S. The acquisition was through a share exchange of two shares in P for every three shares in S. The stock market price of P's shares at 1 October, 2010 was \$4 per share.

The following information is relevant:-

	P	S
	\$'000	\$'000
Equity shares of \$1 each	250,000	160,000
Share premium	100,000	nil
Revaluation reserve (land)	8,400	nil
Other equity reserve (re equity financial asset investment)	3,200	2,200
Retained earnings	90,000	125,000

- (i) P's policy is to revalue the group's land to market value at the end of each accounting period. Prior to its acquisition S's land had been valued at historical cost. During the post acquisition period S's land had increased in value over its value at the date of acquisition by \$1 million. S has recognised the revaluation within its own financial statements.
- (ii) P's policy is to value the non-controlling interest of S at the date of acquisition at its fair value which the directors determined to be \$100 million.



Mini Exercises – Questions

ACCA F7 March-June'18 Examinations

Question 10

On 1 October, 2010, P secured a majority equity shareholding in S on the following terms: an immediate payment of \$4 per share on 1 October, 2010; and a further amount deferred until 1 October 2011 of \$5.4 million. The immediate payment has been recorded in P's financial statements, but the deferred payment has not been recorded. P's cost of capital is 8% per annum.

Extracts from the two statements of financial position as at 30 September, 2011:

	P	S
Equity shares of \$1 each	50,000	10,000
Retained earnings		
at 1 October, 2010	25,700	12,000
for the year ended 30 September, 2011	9,200	6,000
Investment in S (8 million shares at \$4 each)	32,000	

P's policy is to value the non-controlling interest at fair value at the date of acquisition. For this purpose the directors of P considered a share price for S of \$3.50 per share to be appropriate.

At the date of acquisition, the fair values of S's property, plant and equipment was equal to its carrying amount with the exception of S's plant which had a fair value of \$4 million above its carrying amount. At that date the plant had a remaining life of four years. S uses straight-line depreciation for plant assuming a nil residual value.

Also at the date of acquisition, P valued S's customer relationships as a customer base intangible asset at fair value of \$3 million. S has not accounted for this asset. Trading relationships with S's customers last on average for six years

Question 11

On 1 April, 2011, P acquired 80% of S's equity shares by means of an immediate one for one share exchange and a cash payment of 88 cents per acquired share, deferred until 1 April, 2012. P has recorded the share exchange, but not the cash consideration. P's cost of capital is 10% per annum.

Extracts from the two statements of financial position as at 31 March, 2012:

	P	S
Equity shares of \$1 each	25,000	10,000
Share premium	17,600	-
Retained earnings –		
at 1 April 2011	16,200	18,000
for the year ended 31 March, 2012	14,000	8,000
Investment in S	24,000	

At the date of acquisition, P conducted a fair value exercise on S's net assets which were equal to their carrying amounts with the following exceptions:

- An item of plant had a fair value of \$3 million above its carrying amount. At the date of acquisition it had a remaining life of five years. Ignore deferred tax relating to this fair value.
- S had an unrecorded deferred tax liability of \$1 million, which was unchanged as at 31 March, 2012.

P's policy is to value the non-controlling interest at fair value at the date of acquisition. For this purpose a share price for S of \$3.50 each is representative of the fair value of the shares held by the non-controlling interest.



Mini Exercises – Questions

Question 12

On 1 October, 2012, P acquired 75% of S's equity shares by means of a share exchange of two new shares in P for every five acquired shares in S. In addition, P issued to the shareholders of S a \$100 10% loan note for every 1,000 shares it acquired in S. P has not recorded any of the purchase consideration, although it does have other 10% loan notes already in issue. The market value of P's shares at 1 October, 2012 was \$2 each.

Extracts from the two statements of financial position at 31 March 2013:

	P	S
Equity shares of \$1 each	40,000	20,000
Retained earnings/(losses) –		
at 1 April 2012	19,200	(4,000)
for the year ended 31 March, 2013	7,400	8,000

At the date of acquisition, S produced a draft statement of profit or loss which showed it had made a net loss after tax of \$2 million at that date. P accepted this figure as the basis for calculating the pre- and post-acquisition split of S's profit for the year ended 31 March, 2013.

Also at the date of acquisition, P conducted a fair value exercise on S's net assets which were equal to their carrying amounts (including S's financial asset equity investments) with the exception of an item of plant which had a fair value of \$3 million below its carrying amount. The plant had a remaining economic life of three years at 1 October, 2012.

P's policy is to value the non-controlling interest at fair value at the date of acquisition. For this purpose, a share price for S of \$1.20 each is representative of the fair value of the shares held by the non-controlling interest.

Question 13

On 1 April, 2013, P acquired 75% of the \$6,000 equity share capital of S. S had been experiencing difficult trading conditions and making significant losses. In allowing for S's difficulties, P made an immediate cash payment of only \$1.50 per share. In addition, P will pay a further amount in cash on 30 September, 2014 if S returns to profitability by that date. The value of this contingent consideration at the date of acquisition was estimated to be \$1.8 million, but at 30 September, 2013 in the light of continuing losses, its value was estimated at only \$1.5 million. The contingent consideration has not been recorded by P. Overall, the directors of P expect the acquisition to be a bargain purchase leading to negative goodwill.

At the date of acquisition each 50 cent equity share in S had a listed market price of \$1.20 each.

At the date of acquisition, the fair values of S's assets were equal to their carrying value with the exception of a leased property. This had a fair value of \$2 million above its carrying amount and a remaining lease term of 10 years at that date. All depreciation is included in cost of sales. S retained earnings as at 30 September 2013 and 30 September 2012 respectively were \$11,900 and \$16,600.

P's policy is to value the non-controlling interest at fair value at the date of acquisition. For this purpose, S'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.

Question 14

On 1 October, 2013, P acquired 90 million of S's 150 million \$1 equity shares. The acquisition was achieved through a share exchange of one share in P for every three shares in S. At that date the stock market prices of P's and S's shares were \$4 and \$2.50 per share respectively. Additionally, P will pay \$1.54 cash on 30 September, 2014 for each share acquired. P's finance cost is 10% per annum. The retained earnings of S brought forward at 1 April, 2013 were \$120 million and S profit after tax for the year ended 31 March, 2014 was \$80,000.

The following information is relevant:

A fair value exercise conducted on 1 October, 2013 concluded that the carrying amounts of S's net assets were equal to their fair values with the following exceptions:

- the fair value of S's land was \$2 million in excess of its carrying amount
- an item of plant had a fair value of \$6 million in excess of its carrying amount. The plant had a remaining life of two years at the date of acquisition. Plant depreciation is charged to cost of sales.
- P placed a value of \$5 million on S's good trading relationships with its customers. P expected, on average, a customer relationship to last for a further five years. Amortisation of intangible assets is charged to administrative expenses.
- P's policy is to value the non-controlling interest at the date of acquisition at its fair value. For this purpose, the share price of S at that date (1 October, 2013) is representative of the fair value of the shares held by the non-controlling interest.



Mini Exercises – Questions

ACCA F7 March-June'18 Examinations

Question 15

On 1 January, 2014 P acquired 80% of the \$1 equity shares in S. The consideration was settled by a share for share exchange of 2 shares in P for every 3 shares in S acquired. At the date of acquisition the respective fair values for the shares in P and in S were \$3 and \$2.50. In addition, P has agreed to pay 27.5 cents per share acquired on 1 January, 2015.

The directors of P value non-controlling interests on a fair value basis and the share price of the S shares can be taken to be representative of the fair value. P's cost of capital is 10% per annum.

Profits for the year for P and for S were \$8,000 and \$2,000 respectively

At the date of acquisition the carrying value of the S net assets was equal to their fair value with the exception of the S property that had a fair value \$4 million in excess of its carrying value

Extracts from the two companies' financial statements as at 30 September 2014 were:

	P	S
\$1 Equity shares	10,000	9,000
Revaluation surplus	2,000	-
Retained earnings	6,300	3,500



Mini Exercises – Questions

11 Revenue

Question 1

Revenue includes \$16 million for goods sold to a customer on 1 October, 2008. The terms of the sale are that the company will incur ongoing service and support costs of \$1.2 million per annum for three years after the sale. The company normally makes a gross profit of 40% on such servicing and support work. Ignore the time value of money.

What adjustment is necessary to the financial statements as at 31 March, 2009?

Question 2

Revenue includes goods sold and despatched in September 2011 on a 30-day right of return basis. Their selling price was \$2.4 million and they were sold at a gross profit margin of 25%. The company is uncertain as to whether any of these goods will be returned within the 30-day period.

What adjustment is necessary to the financial statements as at 30 September 2011?

Question 3

On 1 October, 2011, the first day of the accounting period, the company sold one of its products for \$10 million and included this amount in revenue. As part of the sale agreement, the company is committed to the ongoing servicing of this product until 30 September, 2014 (i.e. three years from the date of sale). The value of this service has been included in the selling price of \$10 million. The estimated cost to the company of the servicing is \$600,000 per annum and the normal gross profit margin on this type of servicing is 25%.

What adjustment, if any, is necessary to the financial statements as at 30 September 2012? Ignore discounting.

Question 4

Revenue includes the sale of \$10 million of maturing inventory made to a customer on 1 October, 2012. The cost of the goods at the date of sale was \$7 million and the company has an option to repurchase these goods at any time within three years of the sale at a price of \$10 million plus accrued interest from the date of sale at 10% per annum. At 31 March, 2013, the financial year end, the option had not been exercised, but it is highly likely that it will be before the date it lapses.

What adjustment is necessary to the financial statements as at 31 March, 2013

Question 5

Revenue includes an amount of \$20 million for cash sales made through the company's retail outlets during the year on behalf of Francais. The company, acting as agent for Francais, is entitled to a commission of 10% of the selling price of these goods. By 31 March, 2014, the company had remitted to Francais \$15 million (of the \$20 million sales) and recorded this amount in cost of sales.

What adjustment is necessary to the financial statements?



Mini Exercises – Questions

ACCA F7 March-June'18 Examinations

12 Financial Instruments

Calculate the figures to be included within each entity's financial statements

Question 1

A 5% convertible loan note was issued for proceeds of \$20 million on 1 October, 2007. It has an effective interest rate of 8% due to the value of its conversion option. What figure should be included as finance charges in the statement of profit or loss for the year ended 31 March, 2008?

Question 2

The 5% loan note was issued on 1 April, 2009 at its nominal (face) value of \$20 million. The direct costs of the issue were \$500,000 and these have been charged to administrative expenses. The loan note will be redeemed on 31 March, 2012 at a substantial premium. The effective finance cost of the loan note is 10% per annum. What figures should appear in the financial statements for the year ended 30 September, 2009

Question 3

The 8% \$30 million convertible loan note was issued on 1 April, 2010 at par. Interest is payable annually in arrears on 31 March each year. The loan note is redeemable at par on 31 March, 2013 or convertible into equity shares at the option of the loan note holders on the basis of 30 equity shares for each \$100 of loan note. The company's finance director has calculated that to issue an equivalent loan note without the conversion rights it would have to pay an interest rate of 10% per annum to attract investors.

The present value of \$1 receivable at the end of each year, based on discount rates of 8% and 10% are:

	8%	10%
End of year 1	.925926	.909091
End of year 2	.857339	.826446
End of year 3	.793832	.751315

What value should appear as the interest charge for the year ended 31 March, 2011 and what is the value of the equity element?

Question 4

On 1 April, 2013 the company issued a 5% \$50 million convertible loan note at par. Interest is payable annually in arrears on 31 March, each year. The loan note is redeemable at par or convertible into equity shares at the option of the loan note holders on 31 March, 2016. The interest on an equivalent loan note without the conversion rights would be 8% per annum.

The present values of \$1 receivable at the end of each year, based on discount rates of 5% and 8%, are:

	5%	8%
End of year 1	.952381	.925926
End of year 2	.907029	.857339
End of year 3	.863838	.793832

What value should appear as the interest charge for the year ended 31 March, 2014 and what is the value of the equity element?



MINI EXERCISES – ANSWERS

1 Cost of Sales

Answer 1

Sales		300,000
Op Inv.	15,000	
Purchases	<u>243,000</u>	
	258,000	
Cl Inv.	<u>(18,000)</u>	
Cost of sales		<u>240,000</u>
Gross Profit		<u><u>60,000</u></u>
Answer		<u><u>243,000</u></u>

Answer 2

Sales		450,000
Op Inv	58,333	
Purchases	<u>400,000</u>	
	458,333	
Cl Inv.	<u>(75,833)</u>	
Cost of sales		<u>382,500</u>
Gross profit		<u><u>67,500</u></u>
Answer		<u><u>58,333</u></u>

Answer 3

Sales		500,000
Op Inv.	20,000	
Purchases	<u>440,000</u>	
	460,000	
Cl Inv.	<u>(15,555)</u>	
Cost of sales		<u>444,445</u>
Gross profit		<u><u>55,555</u></u>
Answer		<u><u>15,555</u></u>



Mini Exercises – Answers

ACCA F7 March-June'18 Examinations

2 Intra-group pup

	<i>Cost</i>	+	<i>Profit</i>	=	<i>Selling Price</i>	
1	100 $So\ 20/120 \times 2/3 \times 60,000 = 6,667$ In H ↓ ↓		20		120	
			retained earnings		6,667	
			inventory			6,667
2	75 $So\ 25/120 \times 3/4 \times 40,000 = 7,500$ In S ↓ ↓		25		100	
			retained earnings		7,500	
			inventory			7,500
3	70 $So\ 30/100 \times 100\% \times 80,000 = 24,000$ In A ↓ ↓		30		100	
			retained earnings		24,000	
			inventory			24,000
4	100 $So\ 20/120 \times 66,000 = 11,000$ In A ↓ ↓		20		120	
			retained earnings		11,000	
			inventory			11,000
5	100 $So\ 30/130 \times 40\% \times 100,000 = 9,231$ In A ↓ ↓		30		130	
			retained earnings		9,231	
			inventory			9,231
6	60 $So\ 40/100 \times 100\% \times 30,000 = 12,000$ In A ↓ ↓		40		100	
			retained earnings		12,000	
			inventory			12,000
7	75 $So\ 25/100 \times 0 \times 20,000 = \text{nil}$ No adjustment necessary		25		100	
8	100 $So\ 10/110 \times 5,500 = 500$ In A ↓ ↓		10		110	
			retained earnings		500	
			inventory			500
9	100 $So\ 30/130 \times 0 \times 90,000 = \text{nil}$ No adjustment necessary		30		130	
10	100 $So\ 40/140 \times 60\% \times 22,000 = 3,771$ In A ↓ ↓		40		140	
			retained earnings		3,771	
			inventory			3,771



Mini Exercises – Answers

	Cost	+	Profit	=	Selling Price		
11	80		20		100		
	So $20/100 \times 1/3 \times 15,000 = 1,000$						
	In P Dr retained earnings					1,000	
	Cr inventory						1,000
12	100		50		150		
	So $50/150 \times 100\% \times 1,800 = 600$						
	In P Dr retained earnings					600	
	Cr inventory						600
13	30m		10m		40m		
	So $10/40 \times 12 = 3,000$						
	In S Dr retained earnings					3,000	
	Cr inventory						3,000
14	100		30		130		
	So $30/130 \times 2.6m = 600$						
	In P Dr retained earnings					600	
	Cr inventory						600
15	100		50		150		
	So $50/150 \times 11,600 = 3,867$						
	In P Dr retained earnings					3,867	
	Cr inventory						3,867
16	100		25		125		
	So $25/125 \times 1.5m = 300$						
	In P Dr retained earnings					300	
	Cr inventory						300
17	100		15		115		
	So $15/115 \times 4.6m = 600$						
	In P Dr retained earnings					600	
	Cr inventory						600
18							
	So $1.5/9 \times 3.6 = 600$						
	In S Dr retained earnings					600	
	Cr inventory						600
19	100		25		125		
	So $25/125 \times 1/5 \times 20 = 800$						
	In P Dr retained earnings					800	
	Cr inventory						800
20	100		25		125		
	So $25/125 \times 600 = 120$						
	In P Dr Retained earnings					120	
							120



Mini Exercises – Answers

ACCA F7 March-June'18 Examinations

3 Goodwill

Answer 1

(a)	Cost of investment	900,000
	Nci investment valuation	<u>380,000</u>
		1,280,000
	NA @ doa	
	Shares	800,000
	Ret ears	<u>400,000</u>
		1,200,000
	Goodwill	<u><u>80,000</u></u>
(b)	Cost of investment	900,000
	Nci investment valuation	<u>384,000</u>
		1,284,000
	NA @ doa	
	as above	<u>1,200,000</u>
	Goodwill	<u><u>84,000</u></u>
(c)	Cost of investment	900,000
	Nci investment valuation	<u>360,000</u>
		1,260,000
	NA @ doa	
	as above	<u>1,200,000</u>
	Goodwill	<u><u>60,000</u></u>

Answer 2

(a)	Cost of investment	1,300,000
	Nci investment valuation	<u>310,000</u>
		1,610,000
	NA @ doa	
	Shares	1,000,000
	Ret ears	<u>500,000</u>
		1,500,000
	Goodwill	<u><u>110,000</u></u>



Mini Exercises – Answers

(b)	Cost of investment	1,300,000
	Nci investment valuation	<u>316,000</u>
		1,616,000
	NA @ doa	
	as above	<u>1,500,000</u>
	Goodwill	<u><u>116,000</u></u>

(c)	Cost of investment	1,300,000
	Nci investment valuation	<u>300,000</u>
		1,600,000
	NA @ doa	
	as above	<u>1,500,000</u>
	Goodwill	<u><u>100,000</u></u>

Answer 3

(a)	Cost of investment	350,000
	Nci investment valuation	<u>110,000</u>
		460,000
	NA @ doa	
	Shares	300,000
	Ret ears	<u>100,000</u>
		400,000
	Goodwill	<u><u>60,000</u></u>

(b)	Cost of investment	350,000
	Nci investment valuation	<u>105,000</u>
		455,000
	NA @ doa	
	as above	<u>400,000</u>
	Goodwill	<u><u>55,000</u></u>

(c)	Cost of investment	350,000
	Nci investment valuation (25% x 400,000)	<u>100,000</u>
		450,000
	NA @ doa	
	as above	<u>400,000</u>
	Goodwill	<u><u>50,000</u></u>



Mini Exercises – Answers

ACCA F7 March-June'18 Examinations

4 Goodwill impairments

Answer 1

(a)	Cost of investment	470,000	
	Nci investment valuation	<u>305,000</u>	
			775,000
	NA @ doa		
	Shares	500,000	
	Ret ears	<u>200,000</u>	
			<u>700,000</u>
	Goodwill	75,000	
	Impairment 40%	<u>(30,000)</u>	
			<u>45,000</u>
	(Nci share of impairment 40% x 30,000)		<u>12,000</u>
(b)	Cost of investment	470,000	
	Nci investment valuation	<u>300,000</u>	
			770,000
	NA @ doa		
	as above	<u>700,000</u>	
	Goodwill	70,000	
	Impairment 40%	<u>28,000</u>	
			<u>42,000</u>
	(Nci share of impairment 40% x 28,000)		<u>11,200</u>
(c)	Cost of investment	470,000	
	NA @ doa		
	as above	<u>700,000</u>	
	H's share	60%	<u>420,000</u>
			50,000
	Nci goodwill (given)		<u>15,000</u>
	Goodwill	65,000	
	Impairment 40%	<u>26,000</u>	
			<u>39,000</u>
	(Nci share of impairment 40% x 26,000)		<u>10,400</u>
(d)	Cost of investment	470,000	
	Nci investment valuation (40% x 700,000)	<u>280,000</u>	
			750,000
	NA @ doa		
	as above	<u>700,000</u>	
	Goodwill	50,000	
	Impairment	<u>20,000</u>	
			<u>30,000</u>



Mini Exercises – Answers

Answer 2

(a)	Cost of investment	420,000	
	Nci investment valuation	<u>340,000</u>	
			760,000
	NA @ doa		
	Shares	300,000	
	Ret ears	<u>400,000</u>	
			<u>700,000</u>
	Goodwill		60,000
	Impairment 60%		<u>36,000</u>
			<u>24,000</u>
		(Nci share of impairment 45% x 36,000)	<u>16,200</u>
(b)	Cost of investment	420,000	
	Nci investment valuation	<u>324,000</u>	
			744,000
	NA @ doa		
	as above		<u>700,000</u>
	Goodwill		44,000
	Impairment 60%		<u>26,400</u>
			<u>17,600</u>
		(Nci share of impairment 45% x 26,400)	<u>11,880</u>
(c)	Cost of investment	420,000	
	NA @ doa		
	as above		<u>700,000</u>
	H's share	55%	<u>385,000</u>
			35,000
	Nci goodwill (given)		<u>10,000</u>
	Goodwill		45,000
	Impairment 60%		<u>27,000</u>
			<u>18,000</u>
		(Nci share of impairment 45% x 27,000)	<u>12,150</u>
(d)	Cost of investment	420,000	
	Nci investment valuation 45% x 700,000	<u>315,000</u>	
			735,000
	NA @ doa		
	as above		<u>700,000</u>
	Goodwill		35,000
	Impairment 60%		<u>21,000</u>
			<u>14,000</u>



Mini Exercises – Answers

ACCA F7 March-June'18 Examinations

Answer 3

(a)	Cost of investment	350,000
	Nci investment valuation	<u>85,000</u>
		435,000
	NA @ doa	
	Shares	250,000
	Ret ears	<u>100,000</u>
		350,000
	Goodwill	85,000
	Impairment 50%	<u>42,500</u>
		42,500
	(Nci share of impairment 20% x 42,500)	<u>8,500</u>
(b)	Cost of investment	350,000
	Nci investment valuation	<u>80,000</u>
		430,000
	NA @ doa	
	as above	350,000
	Goodwill	80,000
	Impairment 50%	<u>40,000</u>
		40,000
	(Nci share of impairment 20% x 40,000)	<u>8,000</u>
(c)	Cost of investment	350,000
	NA @ doa	
	as above	<u>350,000</u>
	H's share	80% <u>280,000</u>
		70,000
	Nci goodwill (given)	<u>13,000</u>
	Goodwill	83,000
	Impairment 50%	<u>41,500</u>
		41,500
	(Nci share of impairment 20% x 41,500)	<u>8,300</u>
(d)	Cost of investment	350,000
	Nci investment valuation 20% x 350,000	<u>70,000</u>
		420,000
	NA @ doa	
	as above	350,000
	Goodwill	70,000
	Impairment 50%	<u>35,000</u>
		35,000



Mini Exercises – Answers

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
4 yrs dep
100,000
— (40,000) — 5,000π — 65,000
60,000 ————— 9,000
8,000 ————— 56,000
52,000 — 1,000 xs dep —

So, in S ↓ retained earnings 4,000
↓ TNCA 4,000

Answer 3

4,000 — 1,000 — 5,000
— (800) — (1,000)
200

So, in P Dr retained earnings 800
Cr TNCA 800

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

Plant depreciation 15% × (156,000-26,000)
15% × 130,000
DR Depreciation expense (cos) 19,500
CR Accumulated depreciation 19,500



Mini Exercises – Answers

ACCA F7 March-June'18 Examinations

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
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		
	<u>30,000</u>	<u>95,000</u>		
revaluation deficit	–	3,000		
	<u>30,000</u>	<u>92,000</u>		
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 $12\frac{1}{2} \times \frac{1}{2} \times 24,000$	1,500	
		CR	Accumulated depreciation	1,500
and	DR	TNCA	24,000	
		CR	Cost of sales	24,000
	Dr	Depreciation expense, plant	12,000	
		Cr	Accumulated depreciation	12,000

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



Mini Exercises – Answers

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	
DR	R + D Amortisation	4,000	
CR	Accumulation amortisation		4,000
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

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

Answer 6

Dr	Depreciation expense (cos)	1,000	
Cr	Accum depreciation (building)		1,000
Dr	Depreciation expense (cos)	9,000	
Cr	Accum depreciation (PPE)		9,000
Dr	Amortisation (cos)	1,500	
Cr	Accum amortisation (brand)		1,500
Dr	Impairment (cos)	4,500	
Cr	Brand (INCA)		4,500
Dr	Amortisation (cos)	2,500	
Cr	Accum amortisation (brand)		2,500



Mini Exercises – Answers

ACCA F7 March-June'18 Examinations

Answer 7

Dr	Depreciation expense (cos)	1,500	
Cr	Accum depreciation (PPE)		1,500
Dr	Impairment (cos)	4,000	
Cr	Leashold property (PPE)		4,000
Dr	Depreciation expense (cos)	6,600	
Cr	Plant and equipment (PPE)		6,600

Answer 8

Dr	Depreciation expense (cos)	2,000	
Cr	Accum depreciation (PPE)		2,000
Dr	Land and Buildings (PPE)	800	
Cr	Revaluation reserve (Equity)		800
Dr	Depreciation expense (cos)	5,500	
Cr	Accum depreciation (PPE)		5,500
Dr	New plant (PPE)	4,000	
Cr	Prov for contamination (Provs)		4,000
Dr	Depreciation expense (cos)	1,400	
Cr	Accum depreciation (PPE)		1,400
Dr	Finance charges (P or L expenses)	400	
Cr	Prov for contamination (Provs)		400

Answer 9

Dr	Land (PPE)	5,000	
Dr	Accum depreciation (building)	10,000	
Cr	Revaluation reserve (Equity)		15,000
Dr	Depreciation expense (cos)	2,500	
Cr	Accum depreciation (building)		2,500
Dr	Depreciation expense (cos)	10,000	
Cr	Accum depreciation (PPE)		10,000

Answer 10

Dr	Plant (PPE)	10,000	
Cr	Materials (cos)		3,000
Cr	Labour (cos)		4,000
Cr	Production overheads (cos)		3,000
Dr	Depreciation expense (cos)	6,000	
Cr	Accum depreciation (PPE)		6,000
Dr	Depreciation expense (cos)	1,000	
Cr	Accum depreciation (PPE)		1,000
Dr	Accum depreciation (PPE)	8,000	
Cr	Revaluation reserve (Equity)		8,000
Dr	Depreciation expense (cos)	3,000	
Cr	Accum depreciation (PPE)		3,000



Mini Exercises – Answers

Answer 11

Dr	Accum amortisation (property)	4,000	
	Cr Revaluation reserve (Equity)		4,000
Dr	Amortisation expense (cos)	4,500	
	Cr Accum amortisation (property)		4,500
Dr	Revaluation reserve (Equity)	500	
	Cr Retained earnings (Equity)		500
Dr	Plant (PPE)	25,000	
	Cr Finance lease creditor (liabs)		23,000
	Cr Lease payments (expenses)		2,000
Dr	Finance lease creditors (liabilities)	6,000	
	Cr Lease payments (expenses)		6,000
Dr	Finance lease interest (fin charges)	2,300	
	Cr Finance lease creditors (liabs)		2,300
Dr	Depreciation expense (cos)	5,000	
	Cr Accum depreciation (leased ppe)		5,000
Dr	Depreciation expense (cos)	2,800	
	Cr Accum depreciation (PPE)		2,800

Answer 12

Dr	Land (TNCA)	2,000	
Dr	Buildings (TNCA)	8,000	
Dr	Accum depreciation (buildings)	8,000	
	Cr Revaluation reserve (Equity)		18,000
Dr	Revaluation reserve (Equity)	1,000	
	Cr Retained earnings (Equity)		1,000
Dr	Depreciation expense (cos)	7,500	
	Cr Accum depreciation (PPE)		7,500
Dr	Depreciation expense (cos)	3,000	
	Cr Accum depreciation (building)		3,000

Answer 13

Dr	Depreciation expense (cos)	400	
	Cr Accum depreciation (PPE)		400
Dr	Accum depreciation (PPE)	600	
	Cr Revaluation reserve (Equity)		600
Dr	Land (PPE)	2,000	
Dr	Accum depreciation (building)	5,000	
	Cr Revaluation reserve (Equity)		7,000
Dr	Depreciation expense (cos)	2,500	
	Cr Accum depreciation (building)		2,500
Dr	Depreciation expense (cos)	13,200	
	Cr Accum depreciation (PPE)		13,200



Mini Exercises – Answers

ACCA F7 March-June'18 Examinations

Answer 14

Dr	Land (PPE)	4,000	
Dr	Accum depreciation (building)	400	
	Cr Revaluation reserve (Equity)		4,400
Dr	Depreciation expense (cos)	2,400	
	Cr Accum depreciation (building)		2,400
Dr	Finance lease interest (fin charges)	2,930	
Dr	Finance lease creditor (liabs)	6,270	
	Cr Lease rental paid (expenses)		9,200
Dr	Depreciation expense (cos)	6,000	
	Cr Accum depreciation (owned PPE)		6,000
Dr	Depreciation expense (cos)	7,000	
	Cr Accum depreciation (leased PPE)		7,000

7 Loan interest / preference dividends

Answer 1

$8\% \times 50,000 = 4,000$ loan interest for a full year
 But it's only for 9 months, so S of C1 should be charged with $9/12 \times 4,000 = 3,000$
 Only 2,000 is in the trial balance
 \therefore need to accrue 1,000 (ie $3,000 - 2,000$)

DR	Finance costs	1,000	
	CR Current liabilities		1,000

Answer 2

$8\% \times 20,000 = 1,600$ pref div for a full year
 But, effective rate is 12%
 So full charge should be $12\% \times 20,000 = 2,400$ for a full year
 But these are only in issue for 6 months
 Therefore correct charge in S of CI is $6/12 \times 12\% \times 20,000$ 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

$6\% \times 80,000 = 4,800$ loan interest for a full year
 But this is only a 6 month loan
 So correct S of CI charge is $6/12 \times 6\% \times 80,000$ 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

$10\% \times 41,600 = 4,160$
 Trial balance includes only 2,400
 Therefore need to accrue the difference 1,760 ($4,160 - 2,400$)

DR	Finance costs	1,760	
	CR 6% redeemable pref shares		1,760



Mini Exercises – Answers**Answer 5**

24m @ 8% = 1.92m
 24m @ 6% = 1.50m
 Difference 420,000

Dr	Loan interest (finance charges)	420,000	
	Cr 6% loan account (liabilities)		420,000

Loan interest in the profit or loss account 192,000
 6% loan on statement of financial position 24,420,000

Answer 6

40 million @ 10% x 6/12 = 2 million

Dr	Loan interest (finance charges)	2m	
	Cr Loan account (liabilities)		2m

Answer 7

\$4,160,000

8 Taxation**Answer 1**

Dr	CT	1,600	
	Cr DT		1,600
Dr	P or L	29,900	
	Cr CT		29,900

Answer 2

Dr	DT	1,200	
	Cr CT		1,200
Dr	P or L	17,100	
	Cr CT		17,100

Answer 3

Dr	CT	800	
	Cr DT		800
Dr	Revaluation Reserve	1,200	
	Cr DT		1,200
Dr	P or L	12,200	
	Cr CT		12,200

Answer 4

Dr	CT	200	
	Cr DT		200
Dr	P or L	11,600	
	Cr CT		11,600

Answer 5

Dr	DT	2,400	
	Cr CT		2,400
Dr	P or L	2,800	
	Cr CT		2,800



Mini Exercises – Answers

ACCA F7 March-June'18 Examinations

Answer 6

Dr	Deferred Tax	1,500	
	Cr Current Tax		1,500
Dr	Profit or Loss	16,800	
	Cr Current Tax		16,800

Answer 7

Dr	Deferred Tax	1,800	
	Cr Current Tax		1,800
Dr	Profit or Loss	8,800	
	Cr Current Tax		8,800

Answer 8

Dr	Deferred Tax	250	
	Cr Current Tax		250
Dr	Profit or Loss	6,250	
	Cr Current Tax		6,250

Answer 9

Dr	Current Tax	4,150	
	Cr Deferred Tax		4,150
Dr	Profit or Loss	22,750	
	Cr Current Tax		22,750

Answer 10

Dr	CT	1,800	
	Cr DT		1,800
Dr	Revaluation Reserve	2,400	
	Cr DT		2,400
Dr	P or L	26,100	
	Cr CT		26,100

Answer 11

Dr	Deferred Tax	200	
	Cr Current Tax		200
Dr	Current Tax	1,800	
	Cr Profit or Loss		1,800

Answer 12

Dr	Deferred Tax	1,700	
	Cr Current Tax		1,700
Dr	Profit or Loss	6,800	
	Cr Current Tax		6,800

Answer 13

Dr	Current Tax	3,200	
	Cr Deferred Tax		3,200
Dr	Profit or Loss	29,200	
	Cr Current Tax		29,200

Answer 14

Dr	Revaluation Reserve	1,100	
	Cr Deferred Tax		1,100
Dr	Deferred Tax	2,000	
	Cr Current Tax		2,000
Dr	Profit or Loss	350	
	Cr Current Tax		350



Mini Exercises – Answers

Answer 15

Dr	Current Tax	3,700	
	Cr	Deferred Tax	3,700
Dr	Profit or Loss	34,900	
	Cr	Current Tax	34,900

Answer 16

Dr	Deferred Tax	200	
	Cr	Current Tax	200
Dr	Profit or Loss	1,100	
	Cr	Current Tax	1,100

9 Sundry

Answer 1

Opening inventory	37,800
Purchases	<u>78,200</u>
	116,000
Less closing inventory	<u>43,200</u>
Cost of sales (answer)	<u><u>72,800</u></u>

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



Mini Exercises – Answers

ACCA F7 March-June'18 Examinations

Answer 7

Revenue recognised $\frac{22}{50} \times 50m$	22,000	Answer 1
Costs recognised $\frac{22}{50} \times (12 + 8 + 10)$	13,200	Answer 2
\therefore Profit recognised	<u>8,800</u>	
Costs to date $12 + (\frac{3}{4} \times 8)$	14,000	
+ Attributable profit	<u>8,800</u>	
- Amount received	22,800	
Amounts due from customers	5,700	
	<u><u>17,100</u></u>	Answer 3

Answer 8

Contract is for	40m
Total costs are	<u>32m</u>
Contract profit is	<u>8m</u>

Contract is (per question) 30% complete and $30\% \times 8m$ is 2.4m profit to be recognised

Revenue recognised $30\% \times 40m$	12,000
Costs (balancing figure)	<u>9,600</u>
Profit recognised	<u>2,400</u>
Costs to date (8 + 3 depreciation)	11,000
Attributable profit	<u>2,400</u>
	13,400
Amounts invoiced	<u>–</u>
Amounts due from customers	<u>13,400</u>
Plant cost	12,000
Less depreciation	<u>(3,000)</u>
Carrying value	<u>9,000</u>

Answer 9

Dr Revenue	8,000	
Cr Receivables		8,000

Answer 10

Dr Receivables	10,000	
Cr Administrative expenses		1,300
Cr Loan		8,700
Dr Receivables allowances	600	
Cr Receivables		600

Answer 11

Inventory per question	36,000
Deduct receipts after year end	<u>(2,700)</u>
	33,300
Add back sales at cost sold after year end $100 / 130 \times 7,800$	<u>6,000</u>
Adjusted closing inventory	<u>39,300</u>



Mini Exercises – Answers**Answer 12**

18,000 shares issued @ 75 cents each = 13,500

Dr	Suspense account	13,500	
	Cr Share capital 18,000 @ 50 cents		9,000
	Cr Share premium 18,000 @ (75 - 50)		4,500

Rights fraction calculation

5	@	1.20	6.00
1	@	<u>75</u>	<u>75</u>
6		1.125	6.75

Each share has a theoretical value of $6.75/6 = 1.125$ So the rights fraction is $1.20/1.125$ **10 Goodwill****Answer 1** Petras & Signe

Cost of investment

Shares issued $3,000,000/2 \times 1 \times \6	9,000,000
Cash $3,000,000 \times \$1$	<u>3,000,000</u>
Nci investment	12,000,000
NA @ doa	<u>2,500,000</u>
	14,500,000
Shares	4,000,000
Ret ears	6,500,000
fv adjustment, land	<u>(500,000)</u>
	10,000,000
Goodwill	4,500,000
Impairment	<u>900,000</u>
	<u><u>3,600,000</u></u>

Answer 2 Pyotr & Suzanna

Cost of investment

Shares $18,000,000/3 \times 2 \times \5.75	69,000,000
Cash $18,000,000 \times 2.42/1.1/1.1$	36,000,000
Nci investment	<u>30,000,000</u>
	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	<u>2,400,000</u>
	104,000,000
	31,000,000
Impairment	<u>2,000,000</u>
	<u><u>29,000,000</u></u>



Mini Exercises – Answers**Answer 3** Patricija & Sergejus

Cost of investment

Shares $60\% \times 4/3 \times 2 \times \6

NA @ doa

Shares

Ret ears b/f

Ret ears 6 months

fv adjustment, plant

P's share

Nci goodwill, per question

Goodwill

9,600,000

4,000,000

3,500,000

1,500,000

2,000,000

11,000,000

60% 6,600,000

3,000,000

1,500,0004,500,000**Answer 4** Pious & Sebastian

Cost of investment

Cash

Loan note $116/200 \times \$100$

Nci investment valuation

210,000

58,000

65,000

333,000

NA@ doa

Shares

Ret ears

fv adjustments, property

brand

145,000

120,000

20,000

25,000310,000

Goodwill

23,000**Answer 5** Panda & Sloth

Cost of investment

 $80\% \times 120/5 \times 3 \times \6

Nci investment valuation

345,600,000

76,800,000

422,400,000

NA@ doa

Shares

Ret ears brought forward

Ret ears 6 months

fv adjustments, plant

domain name

120,000,000

152,000,000

10,500,000

5,000,000

20,000,000307,500,000

Goodwill

114,900,000

Mini Exercises – Answers**Answer 6** Peter & Simon

Cost of investment	
Shares $75\% \times 8m / 2 \times 3 \times \3.20	28,800,000
Cash, contingent consideration	4,200,000
Nci investment valuation $25\% \times 8m \times \$4.50$	<u>9,000,000</u>
	42,000,000

NA@ doa	
Shares	8,000,000
Ret ears brought forward	16,500,000
fv adjustment, factory	2,000,000
software	<u>(500,000)</u>
	26,000,000
Goodwill	16,000,000
Impairment	<u>3,800,000</u>
	<u>12,200,000</u>

Answer 7 Prime & Suspect

Cost of investment	
Shares $80\% \times 5000 / 5 \times 3 \times \5	12,000,000
Loan note $80\% \times 5000 / 500 \times 100$	800,000
Nci investment valuation $20\% \times 5,000 \times \3.50	<u>3,500,000</u>
	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	<u>(1,200,000)</u>
	7,000,000
Goodwill	<u>9,300,000</u>

Answer 8

Share issue	$80\% \times 120,000 / 5 \times 3 \times \6	345,600
Nci	$20\% \times 120,000 \times \3.20	<u>76,800</u>
		422,400

FV of SNA @ DoA		
shares	120,000	
ret ears b/f	152,000	
ret ears 6 months	$(21,000 + 2,000)/2$	11,500
fv adjustments	- plant	5,000
	domain	<u>20,000</u>
		308,500
Goodwill		<u>\$113,900</u>



Mini Exercises – Answers

ACCA F7 March-June'18 Examinations

Answer 9

shares	$160,000 \times 75\% / 3 \times 2 \times \4	320,000
nci	(per question)	<u>100,000</u>
		420,000

FV of SNA @ DoA

Shares	160,000
Other equity	2,200
Ret ears	<u>125,000</u>
	<u>287,200</u>

Goodwill 132,800

Answer 10

Cash	$8\text{m} \times \$4$ (per question)	32,000
Deferred cash	$\$5.4\text{m} / 1.08$	5,000
Nci	$2\text{m} \times \$3.50$	<u>7,000</u>
		44,000

FV of SNA @ DoA

Shares	10,000
Ret ears	12,000
FV adjustments:	
– Plant	4,000
– Customer relations	<u>3,000</u>
	<u>29,000</u>

Goodwill 15,000

Answer 11

Shares	$10,000 \times 80\% \times \3 (per question)	24,000
Deferred cash	$10,000 \times 80\% \times 88\text{c} / 1.10$	6,400
Nci	$10,000 \times 20\% \times \3.50	<u>7,000</u>
		37,400

FV of SNA @ DoA

Shares	10,000
Ret ears	18,000
FV adjustments:	
– Plant	3,000
– Deferred tax	<u>(1,000)</u>
	<u>30,000</u>

Goodwill 7,400

Mini Exercises – Answers**Answer 12**

Shares	$20,000 \times 75\% / 5 \times 2 \times \2	12,000
Loan note	$20,000 \times 75\% / 1,000 \times 100$	1,500
Nci	$20,000 \times 25\% \times \1.20	<u>6,000</u>
		19,500

FV of SNA @ DoA

Shares	20,000	
Ret ears b/f	(4,000)	
Ret ears 6 months per question	(2,000)	
FV adjustments:		
Plant	<u>(3,000)</u>	
		<u>11,000</u>
Goodwill		<u>8,500</u>

Answer 13

Shares	$6,000 \times 2 \times 75\% \times \1.50	13,500
Deferred cash payment at valuation		1,800
Nci	$6,000 \times 2 \times 25\% \times \1.20	<u>3,600</u>
		18,900

FV of SNA @ DoA

Shares	6,000	
Ret ears b/f	16,600	
Ret ears 6 months ($6/12 \times \$ (4,700 - 100)$)	(2,300)	
FV adjustments:		
– Leasehold property	<u>2,000</u>	
		<u>22,300</u>
Negative goodwill		<u>(3,400)</u>

Answer 14

Shares	$90\text{m}/3 \times \$4$	120,000
Deferred cash	$90\text{m} \times \$1.54 / 1.10$	126,000
Nci	$60\text{m} \times \$2.50$	<u>150,000</u>
		396,000

FV of SNA @ DoA

Shares	150,000	
Ret ears b/f	120,000	
Ret ears 6 months ($6/12 \times \$80,000$)	40,000	
FV adjustments:		
– Land	2,000	
– Plant	6,000	
– Trading relationship	<u>5,000</u>	
		<u>323,000</u>
Goodwill		<u>73,000</u>

Answer 15

Shares	$80\% \times 9,000/3 \times 2 \times \3	14,400
Deferred cash	$80\% \times 9,000 \times 27.5/1.10$	1,800
Nci	$20\% \times 9,000 \times \2.50	<u>4,500</u>
		20,700

FV of SNA @ DoA

Shares	9,000	
Ret earnings b/f	1,500	
Ret ears 3 months	500	
FV adjustments: Land	<u>4,000</u>	
		<u>15,000</u>
Goodwill		<u>\$5,700</u>



Mini Exercises – Answers

ACCA F7 March-June'18 Examinations

11 Revenue

Answer 1

Dr	Revenue	5m	
	Cr	Deferred income	5m

(2.5 years at \$2 million per year)

Answer 2

Dr	Revenue	2.4m	
	Cr	Receivables	2.4m

Dr	Inventory	1.8m	
	Cr	Cost of sales	1.8m

Answer 3

Dr	Revenue	1.6m	
	Cr	Deferred income	1.6m

(2 years at \$800,000 per year)

Answer 4

Dr	Revenue	10m	
	Cr	Loan Account	10m

Dr	Finance charges	500k	
	Cr	Liabilities / accruals	500k

Dr	Inventory	7m	
	Cr	Cost of sales	7m

Answer 5

Dr	Revenue	20m	
	Cr	Cost of sales	15m
	Cr	Commission income	2m
	Cr	Liabilities (Français)	3m



Mini Exercises – Answers

12 Financial Instruments

Answer 1

$8\% \times \$20 \text{ million} \times 6/12$ \$800,000

Answer 2

Finance charge \$975,000

$((20 \text{ million} - 500,000) \times 6/12 \times 10\%)$

Loan liability \$20,475,000

$(20 \text{ million} - 500,000 + 975,000)$

Answer 3

Finance charge \$2,850,789

Equity \$1,492,111

2,400	.909091	2,181,818	
2,400	.826446	1,983,471	
32,400	.751315	<u>24,342,600</u>	
Loan		28,507,889 @ 10%	\$2,850,789
Equity		<u>1,492,111</u>	
		<u>30,000,000</u>	

Answer 4

Finance charge \$3,690,748

Equity \$3,865,645

2,500	.925926	2,314,815	
2,500	.857339	2,143,347	
52,500	.793832	<u>41,676,193</u>	
Loan		46,134,355 @ 8%	\$3,690,748
Equity		<u>3,865,645</u>	
		<u>50,000,000</u>	



