FINANCIAL REPORTING [P1] – PROFESSIONAL LEVEL

Marks

Question No. 1

York Group
Consolidated Statement of Profit or Loss and Other Comprehensive Income
for the year ended 31 December 2017

	Rs. '000'	Marks
Revenue: 228,000 + 123,500 + 114,000 – 3,700 (W-3)	461,800	1 + 0.5
Cost of sales: 90,250 + 27,315 + 26,600 –3700 (W-3) + 75 (W-3) + 75 (W-3)	(140,615)	1.5 + 0.5
Gross profit	321,185	0.5
Distribution costs (16,625 + 10,685 + 9,500)	(36,810)	0.75+0.5
Administrative expenses (17,375 + 4,750 + 9,500)	(31,625)	0.75+0.5
Finance costs	(1,625)	0.5
Profit before tax	251,125	0.25
Income tax expense (41,500 + 26,950 + 21,205)	(89,655)	0.75+0.5
Profit for the year	161,470	0.25
Other comprehensive income for the year (items that will not be reclassified to P/L)		
Revaluation of property (1,000 + 500)	1,500	0.5+0.5
Total comprehensive income	162,970	0.25
Profit attributable to:		
Owners of the parent	142,903	0.5
Non-controlling interest (W-2)	18,567	0.5
	161,470	0.25
Total comprehensive income attributable to:		
Owners of the parent	144,353	0.5
Non-controlling interest (W-2)	18,617	0.5
	162,970	0.25

Workings:

W-1: Group structure

York				
|	90%			01
Leon				
|	80%			
Kevin		Effective interest (90% × 80%)	72%	01
		∴ Non-controlling interest	28%	
			100%	

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W-2: Non-controlling interest (SOCI):

	Leon PFY	Leon TCI	Kevin PFY	Kevin TCI	Marks
				Rs. '000'	
Per question	53,800	54,300	47,195	47,195	0.5
Less intragroup trading (W3)	(75)	(75)	(75)	(75)	0.5
	53,725	54,225	47,120	47,120	0.5
x 10%	5,373	5,423			0.5
x 28% (W-1)			13,194	13,194	0.5
		18,567			0.5
			18,617		0.5

W-3: Intragroup trading:

(i) Cancel intragroup sale/purchase:

	Debit	Credit	Marks
		Rs. '000'	
Group revenue (1,300+2,400)	3,700		
Group cost of sales		3,700	01

(ii) Unrealised profit

	Rs. '000'	Marks
Leon (300 x 25/100)	75	0.5
Kevin (375 x 25/125)	75	0.5

Question No. 2

(a) Tahir Company should make an assessment at December 31, 2017 as to whether the Rs. 500,000 meets the criteria for recognition of an asset. This will involve consideration of the probability of the proposed business combination transaction being consummated. If the entity is in the initial stages of researching the viability of the transaction, or considering a number of alternatives, the probability criterion may not be met. If the entity has made a tentative decision to proceed with the business combination, has discontinued exploration of other alternatives and is in the final stages of due diligence type activities the probability criterion may be met. If the transaction is considered probable the Rs. 500,000 should be deferred until the outcome of the negotiations is certain. If a decision is made not to proceed the costs should be expensed immediately following this decision. 05

(b) The acquirer shall disclose information that enables users of its financial statements to evaluate the nature and financial effect of a business combination that occurs either: 01

- During the current reporting period; or 01
- After the end of the reporting period but before the financial statements are authorised for issue. 01

The acquirer shall disclose information that enables users of its financial statements to evaluate the financial effects of adjustments recognised in the current reporting period that relate to business combinations that occurred in the period or previous reporting periods. 02

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Question No. 3

(a) IAS 2 – Inventories: 10

The cost of inventories shall comprise all costs of purchase, costs of conversion and other costs incurred in bringing the inventories to their present location and condition.

Costs of purchase:

The costs of purchase of inventories comprise the purchase price, import duties and other taxes (other than those subsequently recoverable by the entity from the taxing authorities), and transport, handling and other costs directly attributable to the acquisition of finished goods, materials and services. Trade discounts, rebates and other similar items are deducted in determining the costs of purchase.

Costs of conversion:

The costs of conversion of inventories include costs directly related to the units of production, such as direct labour. They also include a systematic allocation of fixed and variable production overheads that are incurred in converting materials into finished goods. Fixed production overheads are those indirect costs of production that remain relatively constant regardless of the volume of production, such as depreciation and maintenance of factory buildings and equipment, and the cost of factory management and administration. Variable production overheads are those indirect costs of production that vary directly, or nearly directly, with the volume of production, such as indirect materials and indirect labour.

The allocation of fixed production overheads to the costs of conversion is based on the normal capacity of the production facilities. Normal capacity is the production expected to be achieved on average over a number of periods or seasons under normal circumstances, taking into account the loss of capacity resulting from planned maintenance. The actual level of production may be used if it approximates normal capacity. The amount of fixed overhead allocated to each unit of production is not increased as a consequence of low production or idle plant. Unallocated overheads are recognised as an expense in the period in which they are incurred. In periods of abnormally high production, the amount of fixed overhead allocated to each unit of production is decreased so that inventories are not measured above cost. Variable production overheads are allocated to each unit of production on the basis of the actual use of the production facilities.

A production process may result in more than one product being produced simultaneously. This is the case, for example, when joint products are produced or when there is a main product and a by-product. When the costs of conversion of each product are not separately identifiable, they are allocated between the products on a rational and consistent basis. The allocation may be based, for example, on the relative sales value of each product either at the stage in the production process when the products become separately identifiable, or at the completion of production. Most by-products, by their nature, are immaterial. When this is the case, they are often measured at net realisable value and this value is deducted from the cost of the main product. As a result, the carrying amount of the main product is not materially different from its cost.

Other costs:

Other costs are included in the cost of inventories only to the extent that they are incurred in bringing the inventories to their present location and condition. For example, it may be appropriate to include non-production overheads or the costs of designing products for specific customers in the cost of inventories. 16 Examples of costs excluded from the cost of inventories and recognised as expenses in the period in which they are incurred are: (a) abnormal amounts of wasted materials, labour or other production costs; (b) storage costs, unless those costs are necessary in the production process before a further production stage; (c) administrative overheads that do not contribute to bringing inventories to their present location and condition; and (d) selling costs. 17 IAS 23 Borrowing Costs identifies limited circumstances where borrowing costs are included in the cost of inventories. 18 An entity may purchase inventories on deferred settlement terms. When the arrangement effectively contains a financing element, that element, for example a difference between the purchase price for normal credit terms and the amount paid, is recognised as interest expense over the period of the financing.

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(b) Those in support of the capital approach argue as follows:

- government grants are a financing device and should be dealt with as such in the statement of financial position rather than be recognised in profit or loss to offset the items of expense that they finance. Because no repayment is expected, such grants should be recognised outside profit or loss. 01
- it is inappropriate to recognise government grants in profit or loss, because they are not earned but represent an incentive provided by government without related costs. 01

Arguments in support of the income approach are as follows:

- because government grants are receipts from a source other than shareholders, they should not be recognised directly in equity but should be recognised in profit or loss in appropriate periods. 01
- government grants are rarely gratuitous. The entity earns them through compliance with their conditions and meeting the envisaged obligations. They should therefore be recognised in profit or loss over the periods in which the entity recognises as expenses the related costs for which the grant is intended to compensate. 01
- because income and other taxes are expenses, it is logical to deal also with government grants, which are an extension of fiscal policies, in profit or loss. 01

Question No. 4

Event-1:

Per paragraph 9 (a) of IAS 10, this is an adjusting event. The event took place during the reporting period and the settlement after the reporting period of the court case confirms that Maira Limited had a present obligation at the end of the reporting period. The entity adjusts any previously recognised provision related to this court case in accordance with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* or recognises a new provision. 03

Event -2:

Per paragraph 11 of IAS 10, this is a non-adjusting event. The decline in fair value does not normally relate to the condition of the investments at the end of the reporting period, but reflects circumstances that have arisen subsequently. Similarly, the entity does not update the amounts disclosed for the investments as at the end of the reporting period, although it may need to give additional disclosure 03

Event -3:

Per paragraph 9 (e) of IAS 10, this is an adjusting event. The discovery of fraud that shows that the financial statements are incorrect has to be adjusted in the financial statements for the relevant reporting period i.e. year ended December 31, 2017. At the year-end, rental expenses are overstated and the bank balance is understated and these need to be corrected to accurately reflect the correct balances at the year-end. 03

Event -4:

Per paragraph 9 (b ii) of IAS 10, this is an adjusting event. The sale of inventories after the reporting period can give evidence about the net realisable value of the inventory at the end of the reporting period. The inventory's net realisable value in early January 2018 is Rs.100,000 whereas the cost of the inventories at December 31, 2017 was Rs.120,000. Using the IAS 2 Inventories rule that inventory is to be valued at the lower of cost and net realisable value, the inventory at the year-end should be included at Rs.100,000 in the financial statements and therefore, the financial statements have to be adjusted to reflect this change. 03

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Event -5:

Per paragraph 9 (c) of IAS 10, the determination after the statement of financial position date of the cost of assets purchased or the proceeds from assets sold before the end of the reporting period is an adjusting event after the reporting period. The adjusting event needs to be recognised in its financial statements for the year ended December 31, 2017. Therefore, the cheque cashed after the year end should be included in the financial statements for the year ended December 31, 2017 i.e.

			Marks
Debit	Property Plant and Equipment	1,650,000	
Credit	Bank	1,650,000	03

Question No. 5

(a) (i) The carrying amount of the plant at December 31, 2016, before the impairment review, is Rs.640,000 [1,000,000 – (180,000 × 2)] where Rs.180,000 is the annual depreciation charge [(1,000,000 cost – 100,000 residual value) ÷ 5 years].

This needs to be compared with the recoverable amount of the plant which must be its value in use as it has no market value at this date. 2.5

Value in use:

Year Ended	Cash flow	Discount factor at 10%	Present value (Rupees)	Marks
December 31, 2017	300,000	0.909	272,700	0.5
December 31, 2018	230,000	0.826	189,980	0.5
December 31, 2019	150,000 +100,000	0.751	187,750	01
			650,430	0.5

At December 31, 2016, the plant's value in use of Rs.650,430 is greater than its carrying amount of Rs.640,000. This means the plant is not impaired and it should continue to be carried at Rs.640,000. 01

(ii) Fairway Company: Rs. '000'

Assets	Per question	Plant write off		Impairment losses	Marks
Goodwill	1,200	1,200	Write off in full	Nil	01
Patent	1,000	1,000	At realisable value	800	01
Factory	3,500	3,500	Pro rata loss of 30%	2,450	1.5
Plant	3,000	2,500	Pro rata of 30%	1,750	1.5
Receivables and cash	1,000	1,000	Realisable value	1,000	01
	9,700	9,200	Value in use	6,000	01

The plant with a carrying amount of Rs.500,000 that has been damaged to the point of no further use should be written off (it no longer meets the definition of an asset). The carrying amounts in the second column above are after writing off this plant.

After this, firstly, goodwill is written off in full.

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Secondly, any remaining impairment loss should write off the remaining assets pro rata to their carrying amounts, except that no asset should be written down to less than its fair value less costs to sell (net realisable value).

After writing off the damaged plant the remaining impairment loss is Rs.3,200,000 (9,200,000–6,000,000) of which Rs.1,200,000 is applied to the goodwill, Rs.200,000 to the patent (taking it to its realisable value) and the remaining Rs.1,800,000 is apportioned pro rata at 30% [1,800,000 ÷(3,500,000 + 2,500,000)] to the factory and the remaining plant. — 02

The carrying amounts of the assets of Fairway Company, at December 31, 2016 after the accident, are as shown in the third column above.

(b) Profit or Loss Amounts:

	Rs. '000'	Marks
Revenue (7,200 – 3,200)	4,000	1
Cost of sales [(7,800 (W-2) x 60%) – 2,400]	(2,280)	1.5
Profit [2,520 (W-3) – 800]	1,720	1

Statement of Financial Position Amounts:

	Rs. '000'	Marks
Non-current assets		
Plant [6,000 – 1,500 (W-2)]	4,500	1
Current assets		
Trade receivables (7,200 – 6,800)	400	1
Amounts due from customers (W-1)	820	0.5

W-1:

	Rs. '000'	Marks
Costs to date (4,000 + 1,500)	5,500	1
Profit to date (W-3)	2,520	0.5
Less progress billings	(7,200)	0.5
Amounts due from customers	820	0.5

Workings:

W-2: Total contract profit:

		Rs. '000'	Marks
Contract price		12,000	0.5
Costs to date	4,000		0.5
Further costs to complete (4,800 – 4,000)	800		1
Plant depreciation to date (6,000 x 12/48)	1,500		1
Remaining depreciation (6,000 x 12/48)	1,500		1
Total expected costs		(7,800)	0.5
Total expected profit on contract		4,200	0.5

W-3: Profit to date:

					Marks
% work completed	=	7,200 ÷ 12,000	=	60%	1
Profit to date	=	4,200 x 60%	=	2,520	0.5

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Question No. 6

Project A 04

This project meets the criteria in IAS 38 for development expenditure to be recognised as an asset. These are as follows.

(a) P – how the intangible asset will generate probable future economic benefits: Customers have already placed advanced orders for the final product after development.

(b) I – its **intention** to complete the intangible asset and use to sell it: Y o intends to finish development of the product

(c) R – the availability of adequate technical, financial and other resources to complete the development and to use or sell the intangible asset: Adequate resources do exist, the project seems to be in the late stages of development.

(d) A – its ability to use or sell the intangible asset: Customers have already placed advanced orders for the final product, so Y Co, ability to use the asset is clear

(e) T – the technical feasibility of completing the intangible assets so that it will be available for use of sale: the capabilities of the product were demonstrated to customers, so the technical feasibility is assured.

(f) E – its ability to measure reliably the expenditure attributable to the intangible asset during its development: Y Co has a reliable estimation of costs to date and to complete.

Hence the costs of Rs.500,000 incurred to date should be capitalised as an intangible asset in the statement of financial position. Once the material is ready for use, the intangible asset should be amortised over its useful life.

Project B 03

This project meets most of the criteria discussed above which would enable the costs to be carried forward, however, it fails on the availability of adequate resources to complete the project. As such, the costs cannot be capitalised and should be recognised as an expense in the statement of profit or loss.

Once funding is obtained the situation can then be reassessed and future costs may be capitalised.

Project C 03

This is a research project according to IAS 38, i.e. original and planned investigation undertaken with the prospect of gaining new scientific or technical knowledge or understanding.

There is no certainty as to its ultimate success or commercial viability and therefore it cannot be considered to be a development project. IAS 38 therefore requires that costs be written off as incurred as an expense in the statement of profit or loss.

THE END

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