CHARTERED ACCOUNTANTS PROGRAM
AUSTRALIA • NEW ZEALAND

FIN317

Main exam questions

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Main exam suggested solutions

CHARTERED ACCOUNTANTS PROGRAM
AUSTRALIA • NEW ZEALAND

Financial Accounting & Reporting (3) 2017 (FIN317)

Main exam

12 December 2017

Time allowed – Three hours
(plus 15 minutes reading time)

This open-book exam contains four (4) short-answer questions to a total of 80 marks

There is a present value and future value table in the Appendix.

This paper contains 14 pages

Announcement

Where a question refers to, or requires candidates to provide, a reference to an Accounting Standard, candidates can use International Standards, Australian Standards or New Zealand Standards.

Question 1 begins on the next page, please turn over

Question 1 (20 marks)

You are an accountant working for Escape Limited, a company that is involved in creating, building and operating 'escape rooms'.

The accounting team is in the process of preparing the financial statements for the year ended 30 June 20X8.

You have been tasked with completing the statement of changes in equity.

You have been provided with the following template for the statement of changes in equity:

Escape Limited **Statement of changes in equity for the year ended 30 June 20X8**						
	Attributable to owners of the parent					
	Issued capital	**Share-based payment reserve**	**Revaluation surplus**	**FVTOCI reserve**	**Retained earnings**	**Total equity**
	$	**$**	**$**	**$**	**$**	**$**
Opening balance at 1 July 20X7	4,000,000	215,000	200,000	–	1,300,000	5,715,000
Total comprehensive income:						
Profit for the year						
Other comprehensive income (OCI)						
<<insert relevant lines here>>						
Total other comprehensive income (OCI)						
Total comprehensive income						
Transactions with owners recorded directly in equity						
Contributions by and distributions to owners						
<<insert relevant lines here>>						
Total transactions with owners						
Closing balance at 30 June 20X8						

Question 1 continues, please turn over

Question 1 (cont.)

You are aware of the following transactions and events that occurred during the year which may affect the statement of changes in equity:

1. **Issue of shares** – On 1 August 20X7, Escape issued 250,000 ordinary shares for $500,000. This brought the total number of ordinary shares on issue to 2,250,000.
2. **Dividend** – On 1 May 20X8, Escape paid a dividend of 10 cents per share.
3. **Employee share scheme** – On 1 July 20X6, Escape granted 5,000 shares to each of its 50 employees, on the condition that the employee remains in Escape's employ during the vesting period. The shares had a fair value of $2 per share at grant date. The following vesting conditions are attached to the shares:
   - The shares will vest on 30 June 20X8 if Escape's profit after tax increases by more than 20% per year, averaged across the two years.
   - The shares will vest on 30 June 20X9 if Escape's profit after tax increases by more than 15% per year, averaged across the three years.

   By 30 June 20X7, two employees had left the company and Escape's earnings had increased by 23%. At that date, Escape's management estimated that earnings would increase by 20% in 20X8 and that a further five employees would leave the company during the year to 30 June 20X8.

   In the year ended 30 June 20X8, only four employees left the company and Escape's earnings increased by 16%. At 30 June 20X8, Escape's management estimated that earnings would increase by 18% in 20X9 and that a further three employees would leave the company during 20X9.

   Escape uses a 'share-based payment reserve' for equity-settled share-based payment transactions. Escape has no other equity-settled share-based payment transaction arrangements currently in place.
4. **Investment** – On 1 March 20X8, Escape purchased shares in Entertainment Limited, a company that is also involved in the physical adventure industry. The shares cost $500,000 and Escape incurred transaction costs of $20,000. Escape has elected to classify the investment at 'fair value through other comprehensive income', under IFRS 9 *Financial Instruments*. The fair value of the investment at 30 June 20X8 was $545,000.
5. **Asset revaluation** – At 1 July 20X7, Escape's only property consisted of a block of land in one of the suburbs of Adelaide.

   During the year ended 30 June 20X8, the following events occurred in relation to property:
   - The fair value of the Adelaide property fell from $800,000 to $550,000.
   - Escape acquired land in Broadbeach Queensland for $400,000 on 1 September 20X7. By 30 June 20X8, the fair value of this property had increased to $480,000.

   After initial recognition, Escape values properties under the revaluation model in IAS 16 para. 31, and revalues them at every year end. It does not apply the IAS 16 revaluation model to any other class of asset.

Profit – For the year ended 30 June 20X8, profit has been calculated to be $420,000. (This figure is the final profit figure and does not require adjustment for the transactions referred to above.)

Question 1 continues, please turn over

Question 1 (cont.)

Required

(a) Prepare all journal entries required during the year ended 30 June 20X8 to account for the transactions and events identified in points 1–5 above. Ignore the impact of tax and show all workings. (13 marks)

(b) Complete the statement of changes in equity for Escape Limited for the year ended 30 June 20X8 in accordance with IAS 1 *Presentation of Financial Statements*. (7 marks)

20 marks

End of Question 1
Exam paper continues, please turn over

Question 2 (20 marks)

Harvey Businesses Limited (Harvey) is an Australian company that owns and operates amusement parks. It has a functional and presentation currency of Australian dollars (AUD).

Harvey has recently considered acquiring a new ride called Freak-Me-Out, which is very popular in amusement parks overseas. The ride is manufactured in the United States (US) and requires specialist installation and inspection prior to it being ready for operation. Harvey is planning for the ride to be the key attraction at its newest 'Thrillseekers' amusement park in Darwin.

Part A (10 marks)

You are the accountant for Harvey who looks after the Thrillseekers operations and you are currently preparing the accounts for the year ended 30 June 20X7. The contract for the Freak-Me-Out ride was signed on 28 February 20X6 and delivery occurred on 15 July 20X7. The ride cost USD1 million, with USD200,000 paid on contract signing and the balance on delivery.

Harvey has a risk management strategy of minimising the risk relating to foreign currency cash flows. In accordance with this strategy, Harvey hedged the final payment for the ride in order to create certainty over the AUD value of the final cash flow that was payable under the contract. It entered into a forward foreign exchange (FX forward) contract on 28 February 20X6 to receive USD800,000 and pay AUD1,052,632 (a forward rate of 0.7600). The contract settled on 15 July 20X7, which was Freak-Me-Out's date of delivery. It was assessed that the hedge was effective for its entire term.

The fair values of the firm commitment cash flows and the FX forward for the relevant dates are as follows:

Fair values of the firm commitment and FX forward

Date	Spot exchange rate AUD/USD	FX forward exchange rate to 15.07.X7 AUD/USD	Fair value of the firm commitment cash flow AUD	Change in fair value of the firm commitment cash flow since inception AUD	Fair value of the FX forward AUD
28.02.X6	0.7700	0.7600	(1,052,632)		–
30.06.X6	0.7200	0.7400	(1,081,081)	(28,449)	29,000
30.06.X7	0.7900	0.7950	(1,006,289)	46,343	(47,000)
15.07.X7	0.8000	0.8000	(1,000,000)	52,632	(52,632)

Required

(a) For the hedge documentation: (3 marks)

(i) Document the risk being hedged.

(ii) Recommend the most appropriate type of hedge, and support your recommendation with a specific reference from the Accounting Standards.

(b) Prepare the journal entries for the hedge accounting for the year ended 30 June 20X7. Ignore tax and show all workings. (5 marks)

(c) Calculate the amount to be recognised for equipment at 15 July 20X7. Show all workings. (2 marks)

10 marks

Question 2 continues, please turn over

Question 2 (cont.)

Part B (10 marks)

On 28 February 20X6, Harvey also purchased and began the construction of a second new ride, the Oscillator. The raw materials to build the ride were purchased from a supplier for $1,200,000. After delivery of materials, there was extensive work required over a number of months to construct and install the Oscillator.

Harvey incurred the following costs:

Date	Item	AUD
28.02.X6	Initial purchase of materials	1,200,000
31.03.X6	Delivery charges	30,000
31.08.X7	Contractor on site construction & installation charges	100,000
30.09.X7	Staff training	15,000
31.10.X7	Final safety inspection	35,000
Future value	Estimate for dismantling costs – in 10 years (future value)	300,000

Dismantling costs are a legal requirement connected with council planning permission for the site.

To pay for the ride and the associated costs, Harvey established a five-year AUD1.5 million loan facility with its bank. The loan has been drawn down to meet each payment as required and incurs interest at the rate of 4.5% per annum. As the loan term is only five years, the interest rate is lower than the current 10-year rate of 5%. 5% is the rate at which Harvey would normally expect to borrow.

Harvey's policy is to depreciate rides over 10 years on a straight-line basis, commencing from when the ride was subject to its final inspection.

For tax purposes, the ride is depreciated over a useful life of seven years on a straight line basis.

Harvey's tax rate is 30%.

Required

(a) Calculate the value that will be recognised in Harvey's interim financial statements as at 31 December 20X7 for the Oscillator. (8 marks)

(b) Calculate the value of the deferred tax balance for the Oscillator at 31 December 20X7 and identify whether it is a deferred tax asset or a deferred tax liability. (2 marks)

10 marks

End of Question 2
Exam paper continues, please turn over

Question 3 (20 marks)

Granny Flat Solutions Limited (GFS) is a Sydney-based company that manufactures and constructs granny flats. It has a year end of 30 September.

GFS has been growing steadily since it was established six years ago. With house prices increasing rapidly, many homeowners are building granny flats in their gardens. Granny Flats can be beneficial in ways such as housing extended family or being rented out to generate income.

GFS offers two different models of granny flat:

- The Acacia – a small, one-bedroom granny flat.
- The Jacaranda – a medium, two-bedroom granny flat.

In July 20X7, GFS won a tender with Duffy Builders (Duffy), a Sydney building company, to sell Duffy granny flats for a new development of luxury housing in Warriewood Valley in Sydney's Northern Beaches region.

Part A (10 marks)

Duffy signed two contracts with GFS. The details of the contracts are as follows:

	Contract 1	**Contract 2**
Contract date	1 August 20X7	15 August 20X7
Specification	One bedroom (The Acacia)	Two-bedroom (The Jacaranda)
Quantity	100	100
Delivery	By GFS	By GFS
Construction	Fully constructed prior to delivery	Not required. Duffy to perform construction on site
Contract price (per granny flat)	$74,000 (including construction and delivery)	$24,000 (including delivery)

Question 3 continues, please turn over

Question 3 (cont.)

Additional information

- GFS were able to offer Duffy a bargain price for the Jacaranda granny flats in Contract 2 because Duffy had entered into Contract 1 just two weeks earlier.
- Duffy has trucks capable of transporting the Jacaranda flat-pack kits, but has requested GFS perform the delivery of the kits as part of the contract.
- The delivery of the Acacia one-bedroom granny flats requires heavy duty trucks and special council clearance. This service will be provided by GFS. It cannot be done by Duffy or be readily organised with third parties.
- GFS's stand-alone selling prices are as follows:

	Acacia $	Jacaranda $
Flat-pack kit	38,000	65,000
Delivery	3,000	2,000
Construction	15,000	–
Total	56,000	67,000

- Five Jacaranda flat-pack kits were delivered in September 20X7 and three Jacaranda flat-pack kits were manufactured, but were still held at GFS factory.

Required

In accordance with IFRS 15 *Revenue from Contracts with Customers* in the books of GFS:

(a) Determine whether the two contracts should be accounted for as separate contracts, or combined and accounted for as a single contract. Justify your answer with reference to the relevant Accounting Standard. (4 marks)

(b) Identify the separate performance obligations in the contracts with Duffy. Justify your answer. (3 marks)

(c) Determine the revenue that GFS should recognise for the month of September 20X7. Show all workings. (3 marks)

10 marks

Question 3 continues, please turn over

Question 3 (cont.)

Part B (10 marks)

Part B is related to Part A

GFS has negotiated to acquire the use of a transport truck under a lease agreement which commences on 1 October 20X7. The lease contains the following key terms:

Initial payment	An initial payment of $100,000 to be paid on 1 October 20X7
Lease payments	Two payments of $170,000 to be paid on 30 September 20X8 and 30 September 20X9
Transfer of ownership	Ownership of the transport truck will transfer to GFS on 30 September 20X9 when the final payment is made.
Interest rate	The interest rate implicit in the lease is 12%

Additional information

- GFS intends to use the transport truck after the lease term has finished.
- GFS estimates the truck's useful life to be eight years.
- GFS's incremental borrowing rate is 14%.
- GFS incurred legal costs of $10,000 in setting up the lease.
- Income tax deductions can be claimed for lease payments and legal costs paid. Interest expense and depreciation calculated for accounting purposes do not give rise to a tax deduction.
- GFS has a tax rate of 30%.

Required

Prepare the journal entries in relation to the lease for the year ending 30 September 20X8. Show all workings.

10 marks

End of Question 3
Exam paper continues, please turn over

Question 4 (20 marks)

Otway Limited purchased 60% of the share capital of Kilcunda Limited on 30 June 20X6. This purchase gave Otway control of Kilcunda. Both companies have a 30 June year end and are subject to a 30% tax rate.

Part A (10 marks)

Acquisition information

At the acquisition date, the recorded net assets of Kilcunda were represented as follows:

Item	$
Share capital (3,000,000 shares)	3,000,000
Retained earnings	8,500,000
Total equity	11,500,000

Except for inventory, Kilcunda's identifiable assets and liabilities at acquisition date were recorded at fair value. The inventory's fair value was $600,000 but was recorded at a cost of $200,000 in Kilcunda's records.

There was an unresolved legal claim against Kilcunda at 30 June 20X6. A competitor claimed that its registered design is being used by Kilcunda in the manufacture of its surfboards. Kilcunda's lawyers believe it has an 80% chance of successfully defending against the $1 million claim. Kilcunda would have needed to pay $300,000 (which would be tax deductible to Kilcunda) for a third party to assume responsibility in respect of this claim.

The following consideration was transferred to obtain the controlling interest in Kilcunda:

- A cash payment of $2,000,000.
- The issue of two shares in Otway for every one share acquired in Kilcunda. Otway's share price at the acquisition date was $1.80.

Question 4 continues, please turn over

Question 4 (cont.)

Other acquisition information

Otway uses the partial goodwill method to calculate goodwill arising on business combinations.

Additional information post acquisition

- Kilcunda's inventory held at acquisition was sold in August 20X6 for $600,000.
- Due to adverse developments in the legal case, Kilcunda decided to settle the claim with its competitor and paid damages of $500,000 in November 20X6.

You are the financial accountant reviewing the work drafted so far in preparing the consolidated financial statements for the year ended 30 June 20X7.

Draft Goodwill calculation at 30 June 20X7

Draft Goodwill calculation for inclusion in consolidated financial statements at 30 June 20X7		
Item	**$**	**$**
Consideration transferred		
– Cash	2,000,000	
– Shares issued (3 million shares acquired × 2 shares issued × $1.80)	10,800,000	
		12,800,000
Non-controlling interest (NCI) at fair value (fair value measured at 30 June 20X7)		3,500,000
		16,300,000
Carrying value of net assets	11,500,000	
Contingent liability (($300,000) × (1 – 30%))	210,000	
Fair value of identifiable net assets (FVINA)		11,710,000
Goodwill		4,590,000

Required

Identify and explain the errors in the draft goodwill calculation in relation to the consolidated financial statements for the year ended 30 June 20X7. You do not have to prepare an amended calculation.

10 marks

Question 4 continues, please turn over

Question 4 (cont.)

Part B (10 marks)

You have reviewed and corrected the draft goodwill calculation. You will now prepare a number of consolidation journal entries based on the following additional information:

<table>
<tr><th>Additional information</th><th>Details</th></tr>
<tr><td>1. Sale of machine</td><td>Otway's records:
Sale of machine to Kilcunda on 1 November 20X6
<table><tr><th></th><th>$</th></tr><tr><td>Selling price to Kilcunda</td><td>320,000</td></tr><tr><td>Carrying amount: $250,000
(Cost $300,000 – accumulated depreciation $50,000)</td><td>(250,000)</td></tr><tr><td>Profit on sale</td><td>70,000</td></tr></table>Kilcunda has recorded seven months' straight-line depreciation expense in its general ledger. Both Kilcunda and the group are depreciating the machine based on a remaining useful life of 40 months at the date of sale</td></tr>
<tr><td>2. Intra-group sales</td><td>During May 20X7, Kilcunda made sales to Otway totalling $200,000, which was Kilcunda's cost price. Otway paid Kilcunda for the inventory in June 20X7
Kilcunda would normally charge its external customers $280,000 for these items. Otway sold this inventory for $290,000 to external customers in June 20X7</td></tr>
<tr><td>3. Intra-group financing</td><td>Otway made a $500,000 loan to Kilcunda on 1 February 20X7
Interest of $10,000 was paid on the loan by Kilcunda; however, no principal repayments have yet been made</td></tr>
</table>

Required

Prepare the consolidation journal entries relating to the additional information presented above for the year ended 30 June 20X7. Show all workings.

You are not required to prepare any journal entries for the non-controlling interest.

10 marks

End of Question 4

End of exam questions

Present and future value tables are on the next page in Appendix 1

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Financial Accounting & Reporting (3) 2017 (FIN)

Exam suggested solutions and examiner's feedback

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Question 1 (20 marks)

Part (a) (13 marks)

Transaction/event 1

Date	Description	Dr $	Cr $
01.08.X7	Cash	500,000	
	Ordinary share capital (equity)		500,000
To recognise the share issue in equity			

Transaction/event 2

Date	Description	Dr $	Cr $
01.05.X8	Dividend paid (equity)	225,000	
	Cash		225,000
To recognise the dividend payable when declared (2,250,000 shares @ 10c)			

Transaction/event 3

Year	Calculation	Expense for period $	Cumulative $
20X7	Opening balance given in SOCE template		215,000[c]
20X8	41 employees[a] × 5,000 × $2 × 2/3[b] years	58,333	273,333

Notes

a. 50 employees – 2 actual departures in X7 – 4 actual departures in 20X8 – 3 anticipated departures in 20X9.

b. 20X7 actual earnings increase 23% + 20X8 actual earnings increase 16% + 20X9 anticipated earnings increase 18% = three-year average of 19%. As this is higher than the required minimum of 15%, the shares are now expected to vest at the end of year three.

c. Opening balance is (50 – 2 left – 5 anticipated) employees on 30 June 20X7 × 5,000 shares × $2 grant date fair value × ½ = $215,000 as predicted profits should have vested over the two-year period on 30 June 20X7.

Date	Description	Dr $	Cr $
30.06.X8	Remuneration expense	58,333	
	Share-based payment reserve		58,333
To record remuneration expense relating to issuing 5,000 shares			

Transaction/event 4

Date	Description	Dr $	Cr $
01.03.X8	Share investment – Entertainment Limited	500,000	
	Cash		500,000
To recognise the investment in Entertainment Limited			

Date	Description	Dr $	Cr $
01.03.X8	Share investment – Entertainment Limited	20,000	
	Cash		20,000
To capitalise the transaction costs			

Date	Description	Dr $	Cr $
30.06.X8	Share investment – Entertainment Limited	25,000	
	FVTOCI reserve		25,000
To recognise in OCI the change in fair value of investment in Entertainment Limited ($545,000 – $520,000)			

Transaction/event 5

Date	Description	Dr $	Cr $
01.09.X7	Land	400,000	
	Cash		400,000
To recognise purchase of Broadbeach land			

Date	Description	Dr $	Cr $
30.06.X8	Land	80,000	
	Revaluation surplus		80,000
To recognise the revaluation increment on Broadbeach land			

Date	Description	Dr $	Cr $
30.06.X8	Revaluation surplus	200,000	
	Revaluation expense (P&L)	50,000	
	Land		250,000
To recognise the revaluation decrement on Adelaide land, reversing previous decrement and taking balance to P&L			

Part (b) (7 marks)

Escape Limited **Statement of changes in equity for the year ended 30 June 20X8**						
	Attributable to owners of the parent					
	Issued capital	**Share-based payment reserve**	**Revaluation surplus**	**FVTOCI reserve**	**Retained earnings**	**Total equity**
	$	**$**	**$**	**$**	**$**	**$**
Opening balance at 1 July 20X7	4,000,000	215,000	200,000	–	1,300,000	5,715,000
Total comprehensive income:						
Profit for the year	–	–	–	–	420,000	420,000
Other comprehensive income (OCI)						
Revaluation of property, plant and equipment			(120,000)			(120,000)
Fair value of FVTOCI investments	–	–	–	25,000		25,000
Total other comprehensive income (OCI)	**–**	**–**	**(120,000)**	**25,000**		**(95,000)**
Total comprehensive income	**–**	**–**	**(120,000)**	**25,000**	**420,000**	**325,000**
Transactions with owners recorded directly in equity						
Contributions by and distributions to owners						
Proceeds on share issue	500,000	–	–	–	–	500,000
Cost of share-based payments	–	58,333	–	–	–	58,333
Dividends paid	–	–	–	–	(225,000)	(225,000)
Total transactions with owners	**500,000**	**58,333**	**–**	**–**	**(225,000)**	**333,333**
Closing balance at 30 June 20X8	**4,500,000**	**273,333**	**80,000**	**25,000**	**1,495,000**	**6,373,333**

Learning outcomes

Unit	Learning outcome
Unit 2	2. Prepare, analyse and explain a complete set of financial statements
Unit 7	2. Explain and account for property, plant and equipment during its useful life
Unit 9	2. Account for financial assets, financial liabilities and equity instruments of the issuer
Unit 14	1. Identify and account for share-based payments

Question 2 (20 marks)

Part A (10 marks)

(a) (3 marks)

Hedge documentation:

(i) Hedged risk – the contract to purchase the Freak-Me-Out ride is a firm commitment. The hedged risk is the risk of an increase in the final USD cash flow of 800,000 relating to the equipment purchase due to changes in foreign exchange (FX) rates.

(ii) Type of hedge – cash flow hedge. Paragraph 6.5.4 of IFRS 9 *Financial Instruments* indicates that a hedge of a foreign currency risk relating to a firm commitment may be accounted for as either a cash flow hedge or a fair value hedge. Para. 6.5.2(b) of IFRS 9 indicates that a hedge of the exposure to variability in cash flows is a cash flow hedge.

(b) (5 marks)

Journal entries for year ended 30 June 20X7:

Cash flow hedge

Cash flow hedge reserve (CFHR) balance at 30 June 20X6 = $28,449 Cr.

CFHR balance required at 30 June 20X7 = $46,343 Dr (lower of cumulative change in fair value of firm commitment and FX forward).

Change required to achieve CFHR balance at 30 June 20X7 = **$74,792** Dr ($46,343 debit balance at 30 June 20X7 compared with $28,449 credit balance at 30 June 20X6).

FX forward balance at 30 June 20X7 = $47,000 Cr.

Change required to achieve FX forward balance at 30 June 20X7 = **$76,000** Cr ($47,000 liability at 30 June 20X7 compared with $29,000 asset at 30 June 20X6).

Ineffectiveness = **$1,208** Dr (change in FX forward is more than cash flow).

Date	Description	Dr $	Cr $
30.06.X7	Cash flow hedge reserve	74,792	
	Ineffective cash flow hedging (P&L)	1,208	
	FX forward		76,000
To recognise fair value of the FX forward at 30 June 20X7			

(c) (2 marks)

Amount to be recognised for equipment at 15 July 20X7:

Final payment (recognised at the rate at which it was hedged) USD800,000/0.7600	$1,052,632
Initial payment (recognised at the spot rate on the day it was paid) USD200,000/0.7700	$259,740
	$1,312,372

Part B (10 marks)

(a) (8 marks)

Date	Description	Amount AUD	Borrowing cost calculation	Borrowing cost AUD	Total AUD
28.02.X6	Initial payment	1,200,000	20[1] ÷ 12 × 4.5%	90,000	1,290,000
31.03.X6	Delivery	30,000	19 ÷ 12 × 4.5%	2,138	32,138
31.08.X7	Construction and installation	100,000	2 ÷ 12 × 4.5%	750	100,750
30.09.X7	Staff training				
31.10.X7	Final safety inspection	35,000			35,000
31.10.X7	Dismantling costs	184,174[2]			184,174
		1,549,174		**92,888**	**1,642,062**

Notes

1. Number of months from 28.02.X6 to 31.10.X7 = 20.
2. Dismantling costs = $300,000 ÷ (1 + 5%) ^ 10 = $184,174.

	AUD
Cost of Oscillator at 31 December 20X7	1,642,062
Depreciation ($1,642,062 ÷ 120 months × 2 months)	(27,368)
Value to be recognised at 31 December 20X7	1,614,694

(b) (2 marks)

	AUD
Carrying amount	1,614,694
Tax base ($1,642,062 – ($1,642,062 ÷ 84 months × 2 months))	1,602,965
Difference	11,729
Multiplied by tax rate (30%)	3,519 (deferred tax liability)

Learning outcomes

Unit	Learning outcome
Unit 7	2. Explain and account for property, plant and equipment during its useful life
Unit 7	3. Explain and account for borrowing costs in relation to a qualifying asset
Unit 9	2. Account for financial assets, financial liabilities and equity instruments of the issuer (including derivatives)
Unit 9	3. Explain and account for basic cash flow and fair value hedges

Question 3 (20 marks)

Part A (10 marks)

(a) (4 marks)

The contracts should be combined and accounted for as a single contract in accordance with para. 17 of IFRS 15.

Justification:

- The contracts were entered into with the same customer (Duffy) and only two weeks apart.
- The contracts were negotiated as a package with a single commercial objective – to provide granny flats for the development in Warriewood Valley.
- The consideration to be paid in Contract 2 is dependent on the price of Contract 1 (i.e. a bargain price was offered for each Jacaranda granny flat in Contract 2 because Duffy had entered into Contract 1 two weeks earlier when the price of each Acacia granny flat was well above the stand-alone selling price).

(b) (3 marks)

There are three separate performance obligations in the contracts with Duffy:

1. Provision of Acacia flat-pack kits, construction and delivery of the granny flats.
2. Provision of Jacaranda flat-pack kits.
3. Delivery of Jacaranda flat-pack kits.

Justification:

- Duffy is unable to transport the constructed Acacia granny flats as they require specialist transport and techniques. GFS have integrated the provision of the Acacia flat-pack kits, and the construction and delivery of the granny flats; therefore, these obligations are not distinct and should be combined as one performance obligation.
- Duffy can benefit from the Jacaranda flat-pack kits and their delivery on their own or with other readily available resources – these are separately identifiable obligations within the contract. Therefore, these obligations are distinct and are two separate performance obligations.

(c) (3 marks)

An amount of $422,277 should be recognised as revenue for the month of September 20X7.

Workings:

Performance obligation	Stand-alone selling price $	Working $	Transaction price allocation $
Acacia	56,000	56,000 ÷ 123,000 × 9,800,000	4,461,789
Jacaranda flat-pack kit	65,000	65,000 ÷ 123,000 × 9,800,000	5,178,862
Delivery	2,000	2,000 ÷ 123,000 × 9,800,000	159,349
Total	123,000		9,800,000*

* Contract price ($74,000 × 100) + ($24,000 × 100).

Total revenue for September 20X7 = 5 Jacaranda flat-pack kits plus delivery + 3 Jacaranda flat-pack kits

= ((5 × ($5,178,862 + $159,349) ÷ 100) + (3 × $5,178,862 ÷ 100))

= $266,911 + $155,366

= $422,277

Part B (10 marks)

Journal entries for the year ending 30 September 20X8:

Date	Description	Dr $	Cr $
01.10.X7	Right of use asset	387,309	
	Lease liability [*Working 1*]		387,309
To record the right of use asset and lease liability			

Date	Description	Dr $	Cr $
01.10.X7	Right of use asset	10,000	
	Cash		10,000
To record the right of use asset and the cash paid for legal fees			

Date	Description	Dr $	Cr $
01.10.X7	Lease liability	100,000	
	Cash		100,000
To record the initial payment made on 1 October 20X7			

Date	Description	Dr $	Cr $
30.09.X8	Depreciation expense	49,664	
	Accumulated depreciation		49,664
To record the depreciation of the right of use asset over its useful life to the entity			

Note: This entry will be the same every year for 8 years ($397,309 ÷ 8) unless there is a change in estimate.

Date	Description	Dr $	Cr $
30.09.X8	Lease liability	135,523	
	Interest expense	34,477	
	Cash		170,000
To record lease payment made at 30 September 20X8 [*Working 2*]			

Date	Description	Dr $	Cr $
30.09.X8	Income tax expense	58,758	
	Deferred tax liability		58,758
To record the deferred tax on the lease [*Working 3*]			

Workings

Working 1 (lease liability)

The lease liability would be recognised at $387,309 on initial recognition on 1 October 20X7.

Date	Payment $	Present value factor	Present value cash flow $
01.10.X7	100,000	1	100,000
30.09.X8	170,000	0.893	151,786
30.09.X9	170,000	0.797	135,523
Total			387,309

Working 2 (lease payment)

Date	Opening balance $	Interest @ 12% $	Repayment $	Closing balance $
01.10.X7	387,309	0	(100,000)	287,309
30.09.X8	287,309	34,477	(170,000)	151,786
30.09.X9	151,786	18,214	(170,000)	–

The complete lease payment schedule has been shown here for information only.

Working 3 (deferred tax)

The net carrying amount of the lease ($195,859) exceeds the tax base of $0 because the lease is not recognised for tax purposes. A deferred tax liability of $58,758 is recognised for this taxable temporary difference ($195,859 × 30%).

The net carrying amount of the lease = right of use asset $347,645 ($387,309 + $10,000 – $49,664) minus $151,786 liability (from *Working 2*).

Learning outcomes

Unit	Learning outcome
3	1. Identify, measure and recognise revenue from contracts with customers
4	3. Calculate and account for deferred tax
12	2. Explain and account for lease transactions (for lessees)

Question 4 (20 marks)

Part A (10 marks)

Acceptable errors in the draft goodwill calculation and their explanations included the following:

Error	Explanation
Shares issued	Only 60% of Kilcunda's shares were acquired. Therefore, 3,600,000 shares were issued by Otway at $1.80 per share giving a value of $6,480,000 (60% of 3 million shares acquired × 2 shares issued × $1.80)
Non-controlling interest (NCI) at fair value	Partial goodwill was used for the business combination but the calculation uses a fair value for the NCI (when the NCI should be valued at 40% of the fair value of identifiable net assets (FVINA))
NCI at fair value	The NCI value is measured at the acquisition date, not at the current reporting date
Contingent liability adjustment	The adjustment should be subtracted rather than added
Contingent liability adjustment	The contingent liability adjustment should be made for $350,000 (subtracting $350,000 ($500,000 × (1 - 30%)) from the FVINA) as this is a measurement period adjustment
Inventory fair value adjustment	The goodwill calculation should include an acquisition date fair value adjustment for inventory (adding $280,000 ($400,000 × (1 - 30%)) to the FVINA)

If correctly calculated, the goodwill would be $1,622,000, as shown below. Note that candidates were not required to perform this recalculation.

Goodwill calculation for inclusion in consolidated financial statements at 30 June 20X7		
Item	$	$
Consideration transferred		
– Cash		2,000,000
– Shares issued (60% of 3 million shares acquired × 2 shares issued × $1.80)		6,480,000
		8,480,000
NCI's proportionate share of Kilcunda's FVINA (40% × $11,430,000)		4,572,000
		13,052,000
Carrying value of net assets	11,500,000	
Fair value adjustments (net of tax)		
Inventory ($400,000 × (1 – 30%))	280,000	
Contingent liability ($500,000 × (1 – 30%))	(350,000)	
FVINA		11,430,000
Goodwill		1,622,000

Part B (10 marks)

Item 1 – sale of machine

Date	Account description	Dr $	Cr $
30.06.X7	Gain on sale of machine	70,000	
	Machine		20,000
	Accumulated depreciation – machine		50,000
To eliminate the unrealised profit on the intragroup transfer of the depreciable asset and reinstate the accumulated depreciation			

Date	Account description	Dr $	Cr $
30.06.X7	Deferred tax asset (DTA)	21,000	
	Income tax expense		21,000
To recognise the tax effect on the transfer of the depreciable asset			

Workings – recognition of the DTA

Item	Carrying amount to the group at 1 November 20X6 $	Tax base to Kilcunda at 1 November 20X6 $	Deductible temporary difference at 1 November 20X6 $
Machinery	250,000	320,000	70,000
DTA at 30%			21,000

Date	Account description	Dr $	Cr $
30.06.X7	Accumulated depreciation – machine	14,000	
	Depreciation expense		14,000
To adjust the depreciation recognised by the group			

Workings – consolidation depreciation adjustment:

Item	Calculation	Amount $
Kilcunda's depreciation expense since the machine's acquisition on 1 November 20X6	$320,000 ÷ 40 months × 8 months	64,000
Group's depreciation expense based on carrying value at the time of the sale over the remaining useful life of the machine	$250,000 ÷ 40 months × 8 months	50,000
Consolidation adjustment required to reduce depreciation		14,000

Alternatively, the consolidation adjustment required can be calculated as:

Profit on sale	$70,000
÷ remaining useful life	40 months
Monthly adjustment required	$1,750
Adjustment for 8 months =	$14,000

Date	Account description	Dr $	Cr $
30.06.X7	Income tax expense	4,200	
	DTA		4,200
To adjust the related tax effect on the depreciation adjustment ($14,000 × 30%)			

Item 2 – intra-group sales

Date	Account description	Dr $	Cr $
30.06.X7	Sales	200,000	
	Cost of sales		200,000
To eliminate the intragroup sales			

Note: There is no unrealised profit as all inventory was sold to external customers in June 20X7. The regular selling price is irrelevant as the sale was made at cost.

Item 3 – intra-group financing

Date	Account description	Dr $	Cr $
30.06.X7	Loan payable	500,000	
	Loan receivable		500,000
To eliminate outstanding borrowing			

Date	Account description	Dr $	Cr $
30.06.X7	Interest revenue	10,000	
	Interest expense		10,000
To eliminate interest on the borrowing			

Learning outcomes

Unit	Learning outcome
Unit 4	3. Calculate and account for deferred tax
Unit 7	2. Explain and account for property, plant and equipment during its useful life
Unit 15	3. Explain and account for a business combination in the books of the acquirer 4. Account for subsequent adjustments to the initial accounting for a business combination
Unit 16	3. Explain and account for a consolidation for a partly-owned subsidiary

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