CHARTERED ACCOUNTANTS PROGRAM
AUSTRALIA · NEW ZEALAND

FIN115

Main exam questions

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Main exam suggested solutions

CHARTERED ACCOUNTANTS PROGRAM
AUSTRALIA · NEW ZEALAND

Financial Accounting & Reporting (1)
2015 (FIN)

Main exam

28 April 2015

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

On the last page of this exam paper, there are two present value tables

This paper contains 14 pages (including this page) (over to page 2)

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 following page, please turn over

Question 1 (20 marks)

Part A (12 marks)

Background

JR Limited (JR) operates a business that manufactures and leases large specialised mining trucks.

On 1 July 20X5, JR enters into a five-year, non-cancellable lease arrangement with Gold Mining Limited (GM).The lease is for a specialised truck. The truck has a useful life of seven years, after which it will have no residual value. The fair value of the truck at the inception of the lease is $1,849,050. There is a bargain purchase option for $400,000 that GM can exercise at the end of the fifth year of the lease and GM intends to exercise this option.

The lease involves GM making five annual payments of $450,000, with the first payment due on 30 June 20X6. GM depreciates equipment such as this truck on a straight-line basis. The interest rate implicit in the lease is 12 per cent.

The cost to JR to manufacture the truck is $1,600,000.

JR management has classified the lease as a finance lease.

You have been recently appointed to JR as a financial accountant, and you have been asked by your supervisor to provide advice regarding some matters in accordance with IAS 17 *Leases*.

Required	
(a) Calculate the present value of the minimum lease payments. Show all workings.	(4 marks)
(b) Justify JR's classification of the lease as a finance lease, by providing two facts that support this treatment.	(2 marks)
(c) Prepare the journal entries for the financial year ending 30 June 20X6 in the books of JR as the lessor. (Ignore the impact of tax.)	(6 marks)
	12 marks

Question 1 continues, please turn over

Question 1 (cont.)

Part B (8 marks)

Nicole is a financial accountant at Walker & Jones and is assisting Shoalhaven Limited (Shoalhaven) with the preparation of its financial statements. Nicole has been provided with the following extract from Shoalhaven's financial statements for the years ended 30 June 20X5 and 30 June 20X6:

Extract from the statement of financial position	20X6 $'000	20X5 $'000
Assets		
Current assets		
Cash	900	–
Trade receivables	300	800
Allowance for impairment loss – trade receivables	(40)	(100)
Inventory	1,150	650
Deposits at call	300	–
Interest receivable	5	–
Total current assets	2,615	1,350
Non-current assets		
Property, plant and equipment	2,100	1,500
Accumulated depreciation – Property,		
plant and equipment	(450)	(250)
Total non-current assets	1,650	1,250
Total assets	4,265	2,600
Liabilities		
Current liabilities		
Bank overdraft	250	825
Trade payables	750	625
Accruals	200	225
Provision for employee entitlements	125	100
Total current liabilities	1,325	1,775
Non-current liabilities		
Borrowings	100	50
Total liabilities	1,425	1,825
Net assets	2,840	775

Question 1 continues, please turn over

Question 1 (cont.)

Extract from the statement of profit or loss for the year ended 30 June 20X6	20X6 $'000
Sales	1,500
Cost of sales	(680)
Gross profit	820
Interest revenue	15
Gain on sale of property	100
Impairment loss – trade receivables	(125)
Depreciation	(250)
Interest expense	(30)
Employee benefits	(395)
Net profit for the year	135

Other information

- All sales were on credit.
- The carrying value of the property at the date of disposal was $250,000.
- Shoalhaven's policy is to recognise cash flows related to interest within operating activities.
- All amounts are exclusive of goods and services tax (GST). Ignore any GST implications.

Required

Prepare the cash flows from operating activities component of the statement of cash flows for the year ended 30 June 20X6. Do not prepare disclosure notes. Show your workings.

8 marks

End of Question 1
Exam paper continues, please turn over

Question 2 (20 marks)

Background

K'Pau Limited (K'Pau) is an Australian company that produces packaged snack food made from all-natural ingredients. The company has a 30 June year end. K'Pau has recently won a contract with a major national supermarket chain for the supply of raw organic energy bars.

One of the main ingredients in many of K'Pau's products is cacao. This has always been sourced locally; however, due to the significant increase in production requirements and the need to ensure quality and ethical sourcing, K'Pau has entered into a supply agreement with a producer in Brazil. The supply agreement stipulates that all purchases will be invoiced in Brazilian reals (BRL), settlement is 60 days after invoice date and K'Pau will take legal title to the goods when they are despatched.

Part A (6 marks)

The first order for 5,000 kg of cacao was placed with the Brazilian supplier on 3 May 20X5 at an agreed price of BRL32.50 per kg. The order was despatched on 6 May 20X5 and delivered to K'Pau on 17 May 20X5.

At 30 June 20X5 3,200 kg of cacao from this order was still held in inventory and the full amount of the trade payable was still outstanding.

Relevant exchange rates are as follows:

Date	A$	BRL
3 May 20X5	1	2.16
6 May 20X5	1	2.18
17 May 20X5	1	2.09
30 June 20X5	1	2.02

Required

(a)	Calculate the amount to be initially recognised for both the purchase and the trade payable.	(2 marks)
(b)	The exchange rate has moved during May and June 20X5.	(4 marks)
	(i) Calculate the amount to be recorded in the financial statements at 30 June 20X5 for trade payables and inventory.	
	(ii) Identify any exchange gain or loss arising at 30 June 20X5 and explain how it will be accounted for.	
		6 marks

Question 2 continues, please turn over

Question 2 (cont.)

Part B (8 marks)

After seeing the impact a small movement in the exchange rate can have on a relatively small order, Alice Decker, K'Pau's finance manager, is concerned about future purchases.

Alice has done some research and established that K'Pau could have entered into a forward contract when the order was placed on 3 May 20X5. She is analysing some numbers to see how a forward contract could have impacted the financial statements.

She bases her analysis on the following assumptions:

- Using a forward contract to buy BRL162,500 at a forward rate of A$1:BRL2.15, maturing on 6 July 20X5.
- There is no cost to enter into the forward contract.
- The fair value of the forward contract on 30 June 20X5 is $4,864.

Required

(a)	Determine how the forward contract would be accounted for on initial recognition and at 30 June 20X5, if it was **not** designated as a hedging instrument. You are not required to prepare any journal entries.	(4 marks)
(b)	The cumulative change in the present value of the hedged cash flows at 30 June 20X5, calculated using a daily interest rate of 0.015%, is $5,849. Determine how the forward contract would be accounted for on initial recognition and at 30 June 20X5, if it **was** designated as a hedging instrument in a cash flow hedge. You are not required to prepare any journal entries.	(4 marks)
		8 marks

Question 2 continues, please turn over

Question 2 (cont.)

Part C (6 marks)

K'Pau needs to expand to accommodate the new contract with the national supermarket chain. Such expansion will require significant funding for investment in new production equipment and additional working capital.

To fund the expansion, K'Pau will issue $4 million of convertible notes on 1 July 20X5 at face value. The notes will pay nominal interest of 6% per annum, and the holders will have the option to convert the notes to a fixed number of ordinary shares or to redeem them at face value at the end of the five-year term.

The interest rate on similar notes without a conversion option is 9%.

At the issue date, the present value of the contracted future interest is $933,600 and the present value of the principal cash flows is $2,600,000.

Alice believes that as the conversion terms are very good, it is likely that all holders will convert the notes to ordinary shares. Alice is unsure of any specific guidance on the appropriate accounting treatment. She is considering the substance of the transaction and is confident that the convertible notes should be classified as equity on initial recognition.

Required		
(a)	Determine the correct accounting treatment for the convertible notes on initial recognition. To support your response, provide calculations and include one (1) specific reference to IAS 32 *Financial Instruments: Presentation*.	(4 marks)
(b)	Assume that Alice classified the convertible notes as equity on initial recognition. Identify the fundamental ethical principle at risk from the IESBA *Code of Ethics for Professional Accountants*, if any. Justify your response.	(2 marks)
		6 marks

End of Question 2
Exam paper continues, please turn over

Question 3 (20 marks)

Background

Raptor Limited (Raptor) is the parent entity in a diversified group. Details of two of the investments currently held by Raptor are provided in Parts A and B below.

Part A (8 marks)

On 1 January 20X4 Raptor acquired 70% of the ordinary issued capital of Ozden Limited (Ozden), resulting in Raptor obtaining control over Ozden.

The following information is relevant **at the acquisition date:**

- Cash consideration of $5 million was paid on 1 January 20X4.
- A further cash payment of $500,000 will be payable by 31 March 20X5 if Ozden achieves a profit after tax of $2.5 million in the 12 months to 31 December 20X4. At 1 January 20X4, both parties were confident that this target was achievable, and a fair value of $300,000 was assessed for this payment.
- The book value of identifiable net assets at 1 January 20X4 was $6.9 million.
- At 1 January 20X4 Ozden was a defendant in an ongoing lawsuit. The plaintiff is seeking $1.5 million in damages. The event has been disclosed as a contingent liability in the notes to Ozden's most recent financial statements. Ozden would have needed to pay $1 million (which would be tax deductible to Ozden) for a third party to assume responsibility in respect of this claim.
- The fair value of the non-controlling interest at 1 July 20X3 was $1.8 million.

Additional information

- Raptor uses the full goodwill method to calculate goodwill arising on business combinations.
- The tax rate for both Ozden and Raptor is 25%.

Required

(a) In accordance with IFRS 3 *Business Combinations*, calculate the goodwill that will be recognised in the consolidated financial statements of the Raptor group at 30 June 20X4. Justify any exclusions from your calculation and show all workings. (4 marks)

(b) The following information relates to events occurring **after the acquisition date:** (4 marks)

- Actual profit after tax for the 12 months to 31 December 20X4 for Ozden was $2.25 million, so the further $500,000 contingent consideration was not required to be paid.
- The lawsuit was finalised on 31 October 20X4. Ozden was found not liable for any damages.

Determine whether the two events above will impact on the calculation of goodwill at 30 June 20X5 and explain your reasoning.

8 marks

Question 3 continues, please turn over

Question 3 (cont.)

Part B (12 marks)

On 1 July 20X3 Raptor acquired 30% of the ordinary issued capital of Gedik Limited (Gedik) for $200,000. This acquisition resulted in Raptor obtaining significant influence over Gedik. At the date of acquisition, the identifiable net assets of Gedik were represented as follows:

Identifiable net assets at acquisition date – 1 July 20X3	$
Share capital	300,000
Revaluation surplus	60,000
Retained earnings	240,000
Net assets	600,000

At acquisition date, all identifiable assets and liabilities of Gedik were stated at fair value, with the exception of an item of plant, which was recorded at $10,000 below its fair value. At 1 July 20X4 the plant had a further five-year life, and was being depreciated on a straight-line basis.

Information for the year ended 30 June 20X5

Net assets at 30 June 20X5	$
Share capital	300,000
Revaluation surplus	67,500
Retained earnings	328,000
Net assets	695,500

Details of movements in retained earnings since 1 July 20X3 are as follows:

Movements in retained earnings	$
Balance at 1 July 20X3	240,000
Profit after tax for year ended 30 June 20X4	35,000
Profit after tax for year ended 30 June 20X5	60,000
Dividend paid on 30 June 20X5	(7,000)
Balance at 30 June 20X5	328,000

During the year ended 30 June 20X5, there was a sale of inventory from Gedik to Raptor, with a sales value of $10,000 and a profit of $3,000. All of this inventory was still on hand in the books of Raptor as at 30 June 20X5.

Other information

The tax rate for both Gedik and Raptor is 25%.

Question 3 continues, please turn over

Question 3 (cont.)

Required

Prepare the journal entries as at 30 June 20X5 using the equity method of accounting in the consolidated financial statements of the Raptor group in accordance with IAS 28 *Investment in Associates and Joint Ventures*. Show all workings.

You are not required to calculate the tax effect of the equity carrying value of the investment in Gedik.

12 marks

End of Question 3
Exam paper continues, please turn over

Question 4 (20 marks)

Background

Greymouth Limited (Greymouth) is a manufacturing company currently in the process of finalising its financial statements for the year ended 30 June 20X5.

The following transactions have not yet been accounted for:

1. Greymouth revalued a property on 30 June 20X5 to $11,600,000. Its carrying amount prior to recording the revaluation was $16,800,000 ($18,000,000 revalued amount less $1,200,000 accumulated depreciation).

   There is a balance of $5,800,000 on the revaluation surplus relating to this property.

   Greymouth's accounting policy states that when assets are revalued, the accumulated depreciation is offset against the value of the asset.

2. Greymouth has capitalised $800,000 of development costs during the year, which have already been recognised in the statement of financial position. The project is not yet at the stage where amortisation should be charged. Development costs are deductible for tax when the expenditure is incurred.

3. At 30 June 20X5 Greymouth held plant and machinery that is no longer of use to the business. These assets met the criteria for classification as held-for-sale under IFRS 5 *Non-current assets held for sale and discontinued operations* in June 20X5. The carrying value before classification as held-for-sale was $2,250,000, and Greymouth has signed a sale agreement to sell the assets for $800,000 in July 20X5. Costs to sell are expected to be $100,000. The taxable gain or loss on sale is equal to the accounting gain or loss on disposal and is assessable or deductible once settlement occurs in July 20X5.

4. Greymouth entered into an interest rate swap in January 20X5 as a way of managing interest exposure on its long-term debt. The fair value of the swap at 30 June 20X5 was a $26,000 liability. The interest rate swap is not due to settle before 1 September 20X6.

   All Greymouth's swaps are entered into at zero cost, and are classified as fair value through profit and loss. For tax purposes, the gain or loss on settlement of a swap is the difference between the carrying value and the cost of the swap. Any gain or loss is assessable in the period that settlement of the swap occurs.

5. Greymouth issued share capital on 30 June 20X5. The shares were issued for cash of $800,000 and costs of $75,000 were incurred. The $75,000 in issue costs are tax deductible in the year they are incurred.

   The tax rate is 28%.

Required

For each item listed above, prepare the journal for the accounting treatment, including any deferred tax effect at 30 June 20X5. Show your workings.

20 marks

End of Question 4

End of exam questions

Present value tables are on the next page in Appendix 1

Appendix 1: Present value tables

Present value of $1

Periods	2%	4%	6%	8%	10%	12%	14%	16%	18%	20%
1	0.980	0.962	0.943	0.926	0.909	0.893	0.877	0.862	0.847	0.833
2	0.961	0.925	0.890	0.857	0.826	0.797	0.769	0.743	0.718	0.694
3	0.942	0.889	0.840	0.794	0.751	0.712	0.675	0.641	0.609	0.579
4	0.924	0.855	0.792	0.735	0.683	0.636	0.592	0.552	0.516	0.482
5	0.906	0.822	0.747	0.681	0.621	0.567	0.519	0.476	0.437	0.402
6	0.888	0.790	0.705	0.630	0.564	0.507	0.456	0.410	0.370	0.335
7	0.871	0.760	0.665	0.583	0.513	0.452	0.400	0.354	0.314	0.279
8	0.853	0.731	0.627	0.540	0.467	0.404	0.351	0.305	0.266	0.233
9	0.837	0.703	0.592	0.500	0.424	0.361	0.308	0.263	0.225	0.194
10	0.820	0.676	0.558	0.463	0.386	0.322	0.270	0.227	0.191	0.162

Present value of annuity $1 in arrears

Periods	2%	4%	6%	8%	10%	12%	14%	16%	18%	20%
1	0.980	0.962	0.943	0.926	0.909	0.893	0.877	0.862	0.847	0.833
2	1.942	1.886	1.833	1.783	1.736	1.690	1.647	1.605	1.566	1.528
3	2.884	2.775	2.673	2.577	2.487	2.402	2.322	2.246	2.174	2.106
4	3.808	3.630	3.465	3.312	3.170	3.037	2.914	2.798	2.690	2.589
5	4.713	4.452	4.212	3.993	3.791	3.605	3.433	3.274	3.127	2.991
6	5.601	5.242	4.917	4.623	4.355	4.111	3.889	3.685	3.498	3.326
7	6.472	6.002	5.582	5.206	4.868	4.564	4.288	4.039	3.812	3.605
8	7.325	6.733	6.210	5.747	5.335	4.968	4.639	4.344	4.078	3.837
9	8.162	7.435	6.802	6.247	5.759	5.328	4.946	4.607	4.303	4.031
10	8.983	8.111	7.360	6.710	6.145	5.650	5.216	4.833	4.494	4.192

End of present value tables

End of exam paper

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CHARTERED ACCOUNTANTS PROGRAM AUSTRALIA · NEW ZEALAND

Financial Accounting & Reporting (1)
2015

Exam suggested solutions

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Question 1 (20 marks)

Part A (12 marks)

(a) Calculate the present value of the minimum lease payments. (4 marks)

		$
Present value of five lease payments of $450,000 in arrears, discounted at 12 per cent	$450,000 × 3.605	1,622,250
Present value of the bargain purchase option	$400,000 × 0.567	226,800
PVMLP		1,849,050

Alternative layout:

	Payment $	Discount factor	Present value $
Year 1	450,000	0.893	401,850
Year 2	450,000	0.797	358,650
Year 3	450,000	0.712	320,400
Year 4	450,000	0.636	286,200
Year 5	450,000	0.567	255,150
Bargain purchase	400,000	0.567	226,800
		PVMLP	1,849,050

(b) Justify JR's treatment of the lease as a finance lease by providing two facts that support a finance lease classification. (2 marks)

Factors that indicate that the lease is a finance lease include:

- The lease is for the major part of the economic life of the asset.
- The leased asset is of such a specialised nature that only the lessee can use the asset without major modification.
- At the inception of the lease the PVMLP amounts to substantially all of the fair value of the leased asset.
- The lease is non-cancellable.
- The lease has a bargain purchase option.

Other answers that agreed with the facts in the question and IAS 17 requirements were also accepted.

(c) Prepare the journal entries for the financial year ending 30 June 20X6 in the books of JR as the lessor. (6 marks)

Date	Description	Dr $	Cr $
01.07.X5	Lease receivable	1,849,050	
01.07.X5	Sales revenue		1,849,050
To record sales revenue in accordance with IAS 17			

Date	Description	Dr $	Cr $
01.07.X5	Cost of sales	1,600,000	
01.07.X5	Inventory		1,600,000
Being for the cost of sales to the lessor			

Date	Description	Dr $	Cr $
30.06.X6	Cash	450,000	
30.06.X6	Interest revenue		221,886
30.06.X6	Lease receivable		228,114
To represent the receipt of the lease payment			

Part B (8 marks)

Prepare the cash flows from operating activities component of the statement of cash flows for the year ended 30 June 20X6. Do not prepare disclosure notes. Show your workings. (8 marks)

(**Note:** several methods of calculating cash flow figures were accepted, provided workings were shown. For example, some candidates presented the cash flow via the indirect method.)

Receipts from customers			
	$'000		$'000
Trade receivables opening	800	Allowance impairment loss – trade receivables opening	100
Sales (credit)	1,500	Impairment losses – trade receivables	125
Allowance impairment loss – trade receivables closing	40	Trade receivables closing	300
		Receipts from customers	1,815
	2,340		2,340

Payments to suppliers and employees			
	$'000		$'000
Inventory opening	650	Trade payables opening	625
Employee entitlements – closing	125	Employee entitlements – opening	100
Accruals closing	200	Employee benefits – expense	395
Trade payables closing	750	Accruals opening	225
		Cost of sales	680
		Inventory closing	1,150
Payments to suppliers and employees	1,450		
	3,175		3,175

Interest received			
	$'000		$'000
Interest receivable –opening	0	Interest receivable – closing	5
Interest revenue	15	Interest received	10
	15		15

Shoalhaven Limited Extract from statement of cash flows for the year ended 30 June 20X6 Cash flows from operating activities	
	$
Cash receipts from customers	1,815
Cash paid to suppliers and employees	(1,450)
Interest paid	(30)
Interest received	10
Net cash flow from operating activities	345

Learning outcomes

Unit	Learning outcome
2	1. Advise on the requirements for financial statements
12	2. Analyse a lease and determine its classification between a finance lease and an operating lease 4. Explain and account for a finance lease for both a lessee and a lessor
18	2. Prepare, analyse and explain a complete set of financial statements

Question 2 (20 marks)

Part A (6 marks)

(a) Calculate the amount to be initially recognised for both the purchase and the trade payable (2 marks)

The purchase and trade payable will be initially be recorded at A$74,541.

Workings:

5,000kg × BRL32.50 = BRL162,500

BRL162,500 ÷ 2.18 = A$74,541

(b) Impact of exchange rate movement on: (4 marks)

(i) Trade payables – remeasured at A$80,446 (BRL162,500 ÷ 2.02).

Inventory – not remeasured therefore remains at A$47,706 (3,200kg ÷ 5,000kg × A$74,541).

(ii) Loss on exchange of A$5,905 (A$74,541 – A$80,446) (to profit or loss).

Part B (8 marks)

(a) Accounting treatment of the forward contract on initial recognition and at 30 June 20X5 if it was not designated as a hedging instrument (4 marks)

The forward contract is a derivative instrument and must be categorised as FVTPL under IAS 39.

Entering the forward contract does not require an initial payment and its fair value is $0; therefore, nothing is recognised when the forward contract is entered into.

At 30 June 20X5 the forward contract is recognised as a financial asset at its fair value of $4,864.

The gain is recognised in profit or loss.

(b) Accounting treatment of the forward contract on initial recognition and at 30 June 20X5 if it was designed as a hedging instrument in a cash flow hedge (4 marks)

At 30 June 20X5 the hedge is 83.16% effective ($4,864 ÷ $5,849). It is within the range of 80%-125% and therefore hedge accounting can be applied.

(The hedge effectiveness calculation could also have been performed as $5,849 ÷ $4,864 = 120.3%)

The $4,864 gain is recognised in other comprehensive income via a credit to the cash flow hedge reserve.

Below is the calculation for determining that $4,864 gain is the amount recognised in OCI:

The balance (the effective portion) that is recognised in OCI is limited to the lesser of the:

- cumulative gain or loss on the hedging instrument **($4,864)**, and
- cumulative change in the fair value of the expected future cash flows on the hedged item since inception of the hedge ($5,849).

(There is no ineffective portion to recognise in profit or loss).

Part C (6 marks)

(a) Accounting treatment for the convertible notes on initial recognition (4 marks)

The convertible notes should be classified as a compound financial instrument with the liability and equity components accounted for separately.

On initial recognition the liability is recognised at $3,533,600 ($933,600 + $2,600,000)

The equity component is the residual amount of $466,400 ($4,000,000 - $3,533,600).

IAS 32: paragraph 28 or 31.

(b) The fundamental ethical principle at risk is: (2 marks)

Professional competence and due care.

If the convertible notes are classified as equity, Alice is not following applicable technical standards when preparing the financial information for K'Pau (i.e. this treatment does not comply with IAS 32).

Learning outcomes

Unit	Learning outcome
1	2. Explain a Chartered Accountant's ethical requirements relating to financial reporting
5	1. Explain and account for foreign currency transactions and balances
9	2. Account for financial assets, financial liabilities and equity instruments and derivatives 3. Explain the rules of hedge accounting and be able to account for basic cash flow, fair value and net investment hedges 4. Analyse and explain financial statements disclosures for financial instruments

Question 3 (20 marks)

Part A (8 marks)

(a) Calculation of goodwill (4 marks)

	30 June 20X4	
	$	$
Cash paid	5,000,000	
Contingent consideration	300,000	
Consideration transferred		5.300,000
Fair value (FV) of non-controlling interest		1,800,000
		7,100,000
Assets acquired		
Book value of net assets	6,900,000	
Fair value adjustments		
Contingent liability (1,000,000) × (1 – 25%)	(750,000)	
FVINA		6,150,000
Goodwill acquired		950,000

(b) Impact of contingent consideration not required to be paid and the now finalised contingent liability (4 marks)

Item	Impact on goodwill calculation	Explanation
Contingent consideration	None	Not a measurement period adjustment as it relates to events arising after acquisition date (the profit of Ozden not meeting the target)
Lawsuit (contingent liability)	Will reduce the amount of goodwill (as the FVINA will increase).	Is a measurement period adjustment

Part B (12 marks)

Prepare equity accounting entries in the Raptor group as at 30 June 20X5 (12 marks)

		Dr	Cr
30.06.X5	Dividend revenue	2,100	
30.06.X5	Investment in associate		2,100
	To record the elimination of dividend received by Raptor during the 20X5 year Working: ($7,000 × 30%)		

		Dr	Cr
30.06.X5	Investment in associate	2,250	
30.06.X5	Share of associate's revaluation surplus		2,250
	To record the share of Gedik's post-acquisition revaluation surplus Working: ($67,500 – 60,000 × 30%)		

		Dr	Cr
30.06.X5	Investment in associate	10,050	
30.06.X5	Retained earnings brought forward		10,050
	To record the recognition of Raptors 30% share of Gedik's post acquisition retained earnings Working: refer table below		

		Dr	Cr
30.06.X5	Investment in associate	16,875	
30.06.X5	Share of associate profit after tax		16,875
	To record the recognition of Raptors 30% share of Gedik's profit after tax for the 20X5 year Working: refer table below		

	Opening post-acquisition retained earnings $	**Current year profit after tax $**	**Workings**
Post-acquisition opening retained earnings	35,000		
Current year profit after tax		60,000	
Less: Depreciation re FV adjustment on plant**	(1,500)	(1,500)	$10,000 ÷ 5 years × (1 – 25%)
Less: Unrealised profit- net of tax on inventory transfer		(2,250)	$3,000 × (1 – 25%)
Adjusted balances	33,500	56,250	
30% interest	10,050	16,875	

** $1,250 was also accepted here where candidates calculated depreciation over six years as discussed above [$10,000 ÷ 6 × (1 – 25%)].

Learning outcomes

Unit	Learning outcome
4	3. Calculate and account for deferred tax
15	2. Explain and account for a business combination in the books of the acquirer 3. Account for subsequent adjustments to the initial accounting for a business combination
17	4. Explain and account for an investment using the equity method

Question 4 (20 marks)

1. Property, plant and equipment

Reversal of accumulated depreciation			
Date	**Account description**	**Dr $**	**Cr $**
30.06.X5	Property, plant and equipment – accumulated depreciation	1,200,000	
30.06.X5	Property, plant and equipment		1,200,000
Being the reversal of accumulated depreciation on revaluation in accordance with Greymouth's policy			

Property revaluation			
Date	**Account description**	**Dr $**	**Cr $**
30.06.X5	Revaluation surplus (5,200,000 × (1 – 0.28)	3,744,000	
30.06.X5	Deferred tax liability (5,200,000 × 0.28)	1,456,000	
30.06.X5	Property, plant and equipment		5,200,000
Being the revaluation decrement for PPE with a previous revaluation increment			

Revaluation decrement: $16,800,000 – $11,600,000 = $5,200,000

2. Development costs

Development costs			
Date	**Account description**	**Dr $**	**Cr $**
30.06.X5	Income tax expense (through profit or loss)	224,000	
30.06.X5	Deferred tax liability		224,000
Being the deferred tax liability on development costs			

	Carrying amount $'000	Tax base $'000	Taxable temporary difference $'000
Development costs	800	0	800
	800	0	800

Deferred tax liability is $800,000 × 28% = 224,000.

3. Assets held for sale

Assets held for sale			
Date	**Account description**	**Dr $**	**Cr $**
30.06.X5	Assets held for sale	700,000	
30.06.X5	Loss on reclassification to HFS/impairment expense	1,550,000	
30.06.X5	Property, plant and equipment		2,250,000
30.06.X5	Deferred tax asset ($1,550,000 × 28%)	434,000	
30.06.X5	Income tax expense		434,000
Being the loss on reclassification of assets to held for sale and the deferred tax asset on the loss on the sale			

Assets held for sale are carried at the lower of carrying value and fair value less costs to sell:

Carrying value: $2,250,000.

Fair value less cost to sell: $800,000 – $100,000 = $700,000.

Loss on classification as held for sale to be recognised through profit or loss: $1,550,000.

This loss will be deductible for tax in the year end when the sale is settled but results in a deferred tax asset in the period the loss is recognised.

4. Interest rate swaps

Interest rate swaps			
Date	**Account description**	**Dr**	**Cr**
30.06.X5	Loss on revaluation of interest rate swaps (through profit or loss)	26,000	
30.06.X5	Interest rate swap liability		26,000
30.06.X5	Deferred tax asset	7,280	
30.06.X5	Income tax expense		7,280
Being the recognition of the interest rate swaps and the deferred tax impact			

	Carrying amount $	Tax base $	Deductible temporary difference $
Interest rate swap	26,000	0	26,000

Deferred tax liability is $26,000 × 28% = 7,280.

5. Share capital

Share capital			
Date	**Account description**	**Dr $**	**Cr $**
30.06.X5	Cash at bank	725,000	
30.06.X5	Share capital ($800,000 – $75,000)		725,000
Being the recognition of the share capital net of issue costs			

Learning outcomes

Unit	Learning outcome
2	5. Explain and account for discontinued operations
4	3. Calculate and account for deferred tax
7	2. Explain and account for property, plant and equipment during its useful life
8	2. Explain and account for an intangible asset
9	2. Account for financial assets, financial liabilities equity instruments and derivatives