

# **FIN117**

**Main exam questions**

**&**

**Main exam suggested solutions**



## **Financial Accounting & Reporting (1) 2017 (FIN117)**

# **Main exam**

**2 May 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 18 pages (including this page) (over to page 2)**

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## **Announcement**

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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 a Chartered Accountant at Darcina Limited (Darcina), working on the current tax liability calculation for the year ended 31 March 20X7. You have identified the following issues that may impact your calculation:

Item	Details	Tax treatment
1. Draft profit	<p>The draft profit before tax has been calculated to be \$4,000,000 for the year ended 31 March 20X7</p> <p>Since the end of the reporting period the following information has become available which has not been recognised in the \$4,000,000 draft profit before tax:</p> <p>Darcina was successful in a lawsuit relating to a competitor infringing Darcina's patent two years earlier. Darcina received \$800,000 in compensation from this competitor in April 20X7</p>	Compensation payments are assessable for tax purposes when received
The appropriate accounting treatment for the following items has already been included in the calculation of the \$4,000,000 draft profit before tax		
2. Software licence	Darcina acquired a software licence on 1 December 20X6 for \$240,000. The licence is effective for a period of three years once operational. The software became operational on 1 January 20X7 as part of the implementation of a new computer system	\$100,000 is deductible for tax purposes when paid. The remaining \$140,000 will be tax deductible equally in the years ending 31 March 20X8 and 20X9
3. Consultancy services	<p>Darcina provided consultancy services under a contract to a client. The contract involved Darcina's consultants attending the client's workplace daily to observe and document their work processes</p> <p>The contract ran from 1 February to 30 April 20X7. The total contract fee was \$120,000, which was paid upfront by the customer</p>	This income is assessable for tax purposes when received by Darcina

**Question 1 continues, please turn over**

## Question 1 (cont.)

Item	Details	Tax treatment
The appropriate accounting treatment for the following items has already been included in the calculation of the \$4,000,000 draft profit before tax		
4. Annual leave	Annual leave expense was \$130,000 and annual leave paid was \$150,000	Annual leave is deductible for tax purposes when paid
5. Share-based payment	<p>On 1 April 20X5 (in the previous reporting period) Darcina established an equity-settled share-based payment plan for its eight senior executives, with details of the plan as follows:</p> <ul style="list-style-type: none"> <li>• 5,000 share options were granted to each executive</li> <li>• The fair value of each share option at the grant date was \$5.10</li> <li>• The share options can be exercised on 31 March 20X8 on the condition that the executive is still employed by Darcina</li> <li>• By 31 March 20X6 none of the eight executives had left Darcina and it was anticipated that none would leave before 31 March 20X8</li> <li>• By 31 March 20X7 none of the eight executives had left but it was anticipated that one executive would leave before 31 March 20X8</li> </ul>	Share-based payments are non-deductible for tax purposes
6. Equity accounted investment	<p>Darcina owns 40% of the ordinary shares of Camby Limited (Camby) and has significant influence over the associate</p> <p>Camby made a \$200,000 profit before tax for the year ended 31 March 20X7. It paid a dividend of \$40,000 to its shareholders on 12 February 20X7</p>	In relation to Darcina's investment in Camby the only assessable income is the cash amount of the dividend, which is taxed when received
<b>The tax rate is 30%</b>		

### Required

Calculate the current tax liability for Darcina at 31 March 20X7. Ignoring any IAS 12 *Income Taxes* implications, explain your accounting treatment for item 1 with a specific reference from the Accounting Standards. Show all workings.

20 marks

**End of Question 1**  
**Exam paper continues, please turn over**

## Question 2 (20 marks)

Klima Limited (Klima) offers supply, installation and maintenance service contracts of air conditioners for large building across cities in Australia and New Zealand. Klima's functional currency is the Australian dollar.

Philip Green, a Chartered Accountant working at Klima, has prepared a draft statement of profit or loss for the year ended 31 March 20X7, as shown below.

<b>Klima Limited</b>	
<b>Draft Statement of profit or loss for the year ended 31 March 20X7</b>	
	<b>\$ '000</b>
<b>Revenue from contracts with customers</b>	46,000
Interest income	2,000
<b>Total revenue</b>	<b>48,000</b>
Selling and distribution expenses	1,500
Administrative expenses	2,000
Other expenses	3,400
Finance costs	1,300
<b>Total expenses</b>	<b>8,200</b>
<b>Profit before tax</b>	<b>39,800</b>
Tax expense	7,000
<b>Draft profit after tax</b>	<b>32,800</b>

In addition to the statement of profit or loss, there are a number of issues that require your further consideration which have not yet been reflected in the financial statements:

1. A contract with a New Zealand customer for NZ\$350,000 was recognised as a trade receivable on 15 February 20X7 based on the spot rate at that date. The trade receivable was still outstanding at 31 March 20X7 and remains recorded at the spot rate. The Australian dollar value has not been adjusted.

Relevant exchange rates:

	<b>NZ\$</b>	<b>A\$</b>
15 February 20X7	1	0.96
31 March 20X7	1	0.98
Average for the quarter to 31 March 20X7	1	0.97

2. An outbreak of Legionnaires' disease started in Perth, and the cause was traced back to a contaminated air conditioning system in a building which Klima maintains. Three people contracted the disease in March 20X7 and Klima was notified in early April 20X7. It is probable that Klima will be held liable for A\$5 million in damages, which will not be covered by insurance as the damages would be due to Klima's negligence. The financial statements are expected to be authorised for issue on 1 May 20X7.

**Question 2 continues, please turn over**

## Question 2 (cont.)

3. To hedge its floating rate loan liability, Klima entered into a five-year interest rate swap on 1 April 20X5. There was no initial cost to enter into the rate swap. Klima designated the interest rate swap as the hedging instrument in a cash flow hedging relationship.

Documentation in relation to this hedge shows that the hedged item and the hedging instrument have maintained an economic relationship in the year ended 31 March 20X7, and the relationship is not dominated by credit risk.

The hedge was not entirely effective but was within the boundaries set by the entity at inception of the hedge; therefore, no rebalancing was required. The hedge was correctly taken up to 31 March 20X6, but no entries have yet been recognised for the period to 31 March 20X7.

Relevant fair values are as follows:

Date	Cumulative change in present value of future cash outflow on loan since inception \$	Fair value of swap asset \$
31 March 20X6	(12,800,000)	13,000,000
31 March 20X7	(12,920,000)	13,150,000

This is the first hedge arrangement that Klima has entered into.

4. Klima is revaluing its land. Klima has used the revaluation model under IAS 16 *Property, Plant and Equipment* since 20X5. In 20X5 it took up a revaluation increment of \$2,500,000. At 31 March 20X7 (prior to any adjustments), the land had a carrying amount of \$11,000,000 and a market value of \$10,000,000. The lower market value was due to a downturn in the commercial property market.
5. Klima has a licence to be the exclusive supplier of five key brands of air conditioner in Australia. The licence is recognised as an intangible asset. Due to a loss of market share, it was impaired on 31 March 20X6. The eight-year licence had a cost of \$80,000 and was entered into on 1 October 20X4. It has been amortised on a straight-line basis. An impairment loss of \$7,800 was recognised on 31 March 20X6 and the useful life remained unchanged.

Due to the closure of two competing brands during the year, the conditions which gave rise to this impairment loss have resolved. The licence is assessed to have a value in use of \$58,000 and a fair value of \$57,000, with estimated costs of disposal of \$1,000 at 31 March 20X7. The carrying value at 31 March 20X7 is \$48,400, which reflects amortisation to 31 March 20X7.

### Additional information

Klima uses a two-statement format, and separately presents a statement of profit or loss and a statement of comprehensive income.

**Question 2 continues, please turn over**



**Question 2 (cont.)**

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**Required**

Prepare the statement presenting comprehensive income for Klima Limited for the year ended 31 March 20X7. Apply all relevant Accounting Standards.

The statement of profit or loss is **not** required in your response, but ensure you show all workings. Ignore the impact that issues 1–5 may have on current or deferred income tax. Comparatives and notes are not required.

20 marks

**End of Question 2**  
**Exam paper continues, please turn over**

## Question 3 (20 marks)

### Part A (12 marks)

Nepoli Limited (Nepoli) is an Australian company that offers exclusive cultural tours to Italy. Due to the amount of cash the business generates, Nepoli has a large portfolio of investments, including a portfolio of convertible bonds, and has a year end of 30 June.

The portfolio of convertible bonds is held to increase the return Nepoli earns on its cash reserves. Nepoli actively manages the portfolio – frequently buying and selling bonds to maximise return. The return on the portfolio is measured based on both the contractual payments of the bonds, and gains and losses made from selling the bonds.

One bond within this portfolio was purchased on 1 January 20X7 from Capri Limited for \$7.2 million. Nepoli incurred \$50,000 in brokerage costs for this purchase. The bond has a face value of \$7.5 million and a fixed rate coupon of 5.5%, which is paid on 31 December and 30 June each year. The bond has an effective interest rate per annum of 6.976% and has a fair value of \$7.4 million as at 30 June 20X7.

On maturity, the convertible bonds can either be redeemed for cash of \$7.5 million, or converted into a variable number ordinary shares in Capri Limited of an equivalent value. The number of shares received will be based on the market price on that date.

The bond has already been booked in the general ledger by the treasury team. Below is an extract of the trial balance at 30 June 20X7 relating to the bond before any impairment journal entries have occurred:

	Account no	Account description	Account balance	
			Debit \$	Credit \$
Balance sheet	1-100	Bond investment	7,500,000	
Profit or loss	4-100	Interest received		206,250
Profit or loss	4-200	Loss on revaluation of investments	100,000	

In addition, the treasury team has assessed the 12-month expected credit loss to be 1% of face value, and the lifetime expected credit loss to be 3% of face value. The bond was not credit-impaired when purchased and there has been no significant increase in credit risk since 31 December 20X6.

Fred Quill is the new manager of Nepoli's treasury department. Fred is a little uncertain about the accounting implications of IFRS 9 *Financial Instruments* (IFRS 9), the new Accounting Standard for financial instruments. Fred recently attended a course on IFRS 9 but he was not sure that he fully understood the concepts.

Nepoli has decided to early adopt IFRS 9 due to the benefits it will provide for some of its hedging strategies.

**Question 3 continues, please turn over**

**Question 3 (cont.)**

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<b>Required</b>	
(a) Advise Fred of the correct classification of the bond under IAS 32 <i>Financial Instruments: Presentation</i> and IFRS 9 and explain your reasoning.	(4 marks)
(b) Consider the balances relating to the bond in the general ledger at 30 June 20X7. Advise what the correct general ledger balances should be. Ignore the impact of any impairment and show all workings.	(5 marks)
(c) Explain how impairment on the bond should be calculated and prepare the journal entry for recognising impairment (if any) at 30 June 20X7.	(3 marks)
	<u><b>12 marks</b></u>

**Question 3 continues, please turn over**

## Question 3 (cont.)

### Part B (8 marks)

Klipper Limited (Klipper) has entered into a contract with Deuce Limited (Deuce) on 15 December 20X6. Klipper has **not** yet recognised any revenue from this contract. Klipper has a 31 March year end.

The contract meets the requirements of IFRS 15 *Revenue from Contracts with Customers* (IFRS 15) para. 9. The performance obligations are as follows:

- One year's maintenance for air conditioning – building 1.
- Installation of air conditioning – building 2.

The maintenance on building 1 commenced on 1 January 20X7.

The contract price is \$2,300,000. The contract price includes a \$100,000 project bonus which Klipper will receive if it can complete the building 2 installation by 30 April 20X7. If the installation date is not achieved, the project bonus is zero.

Klipper is waiting on parts from an overseas supplier to complete the installation, and is experiencing some shipping delays. To further complicate matters, the installation must be done in fine weather.

Petra, a Chartered Accountant working for Klipper, has spoken to installation staff and supply chain managers and learns that they are expecting to receive the project bonus. With all the information available, Petra estimates a 55% likelihood of meeting this installation date and receiving the project bonus.

The installation has not yet commenced at 31 March 20X7.

Petra applies IFRS 15 and uses the most likely outcome method to determine variable consideration. The project bonus is material to Klipper.

Klipper has summarised the relative stand-alone selling prices for sales to similar customers. These are:

	Stand-alone selling price \$
Air conditioning maintenance - 12 months	1,600,000
Installation fee for large building air conditioner	955,555

### Required

Determine the revenue which should be recognised for this contract in the statement of profit or loss for the year ended 31 March 20X7. In your response, justify your decisions regarding the project bonus, and support these decisions with specific reference to IFRS 15.

**8 marks**

**End of Question 3**  
Exam paper continues, please turn over

## Question 4 (20 marks)

### Part A (10 marks)

Japstar Limited (Japstar) entered into a lease agreement for a new packaging machine. The lease contract gives Japstar the right to use the machine for the period of the lease. The machine is an identified asset and is a lease for the purposes of IFRS 16 *Leases* (IFRS 16). Japstar uses IFRS 16 to account for its lease agreements.

The lease commences on 1 July 20X6. It includes the following key terms:

Key terms of lease for packaging machine	
Lease payments	Five equal annual payments of \$100,000 to be made in advance. The first payment is due on commencement date and the final payment is due on 1 July 20Y0
Use of the packaging machine	There are no restrictions imposed by the lessor on Japstar's use of the machine; however, Japstar is required to insure the item for accidental damage
Purchase option	Japstar has the option to pay \$200,000 on 1 July 20Y1, which will result in the transfer of legal ownership. At the lease commencement date Japstar is unsure whether it will exercise this option due to uncertainties over the future sales of its products
Return of the machine to the lessor	If Japstar does not exercise the purchase option, it is required to return the machine to the lessor on 1 July 20Y1

### Additional information

- The lessor advises Japstar that the interest rate implicit in the lease agreement is 8%. If it were to borrow to acquire the packaging machine, Japstar's incremental borrowing rate would be 9%.
- Japstar paid a 12-month insurance premium of \$5,000 on 1 July 20X6.
- The useful life of the machine is 10 years.
- Japstar uses the straight-line depreciation method.

### Required

Prepare the journal entries required to record the transactions in the books of Japstar for the year ended 30 June 20X7. Show your workings. Ignore any tax effect.

**10 marks**

**Question 4 continues, please turn over**

## Question 4 (cont.)

### Part B (10 marks)

Petrie Limited (Petrie) is a reporting entity. Petrie acquired a 55% controlling interest in Snappy Limited (Snappy) on 1 July 20X6. The financial accountant is preparing the consolidated financial statements and is seeking your assistance with the following items:

Item	Details	Amount								
1. Gain from a bargain purchase	<p>The fair value of the consideration transferred by Petrie to acquire its controlling interest was \$1,900,000</p> <p>On 1 July 20X6 an acquisition analysis was completed, showing a gain from a bargain purchase. To comply with the requirements of IFRS 3 <i>Business Combinations</i>, the fair value of Snappy's net assets were reviewed and found to be correct. This confirms that the gain from a bargain purchase was correctly calculated.</p> <p>At the acquisition date, the identifiable assets and liabilities of Snappy were recorded at fair value and were represented as follows:</p> <table border="1" data-bbox="419 882 847 1072"> <thead> <tr> <th>Net assets</th> <th>\$</th> </tr> </thead> <tbody> <tr> <td>Share capital</td> <td>6,000,000</td> </tr> <tr> <td>Retained earnings</td> <td>(2,000,000)</td> </tr> <tr> <td>Total equity</td> <td>4,000,000</td> </tr> </tbody> </table>	Net assets	\$	Share capital	6,000,000	Retained earnings	(2,000,000)	Total equity	4,000,000	\$300,000 gain from a bargain purchase
Net assets	\$									
Share capital	6,000,000									
Retained earnings	(2,000,000)									
Total equity	4,000,000									
2. Inventory sale	<p>In June 20X7, Snappy sold inventory to Petrie for \$110,000 and made a \$30,000 gross profit on the sale. Snappy would normally make a \$40,000 gross profit if the sale was made to an external customer</p> <p>At 30 June 20X7 Petrie has not sold any of this inventory but had paid for the inventory purchase</p>	\$110,000 inventory sale								
3. Management fee	Petrie charged Snappy a management fee for helping to oversee Snappy's business for the year. The fee was still to be paid by Snappy at the end of the reporting period	\$400,000								

### Other information

- The tax rate for both companies is 30%.
- Both companies have a 30 June year end.

**Question 4 continues, please turn over**

**Question 4 (cont.)**

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**Required****For the year ended 30 June 20X7:**

- (a) Prepare the consolidation journal entries required to prepare Petrie's consolidated financial statements. Show all workings. (6 marks)

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

- (b) Identify if items 2 and 3 have an impact on the calculation of the non-controlling interest. Explain your reasoning for each of these items. (4 marks)

You are not required to perform calculations or prepare any journal entries.

**10 marks**

**End of Question 4**

**End of exam questions**

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

## Appendix 1: Present and future value tables

Periods	Present value of \$1																
	0.25%	0.50%	0.75%	1.00%	1.50%	2.00%	2.50%	3.00%	4.00%	5.00%	6.00%	7.00%	8.00%	9.00%	10.00%	11.00%	12.00%
1	0.99751	0.99502	0.99256	0.99010	0.98522	0.98039	0.97561	0.97087	0.96154	0.95238	0.94340	0.93458	0.92593	0.91743	0.90909	0.90090	0.89286
2	0.99502	0.99007	0.98517	0.98030	0.97066	0.96117	0.95181	0.94260	0.92456	0.90703	0.89000	0.87344	0.85734	0.84168	0.82645	0.81162	0.79719
3	0.99254	0.98515	0.97783	0.97059	0.95632	0.94232	0.92860	0.91514	0.88900	0.86384	0.83962	0.81630	0.79383	0.77218	0.75131	0.73119	0.71178
4	0.99006	0.98025	0.97055	0.96098	0.94218	0.92385	0.90595	0.88849	0.85480	0.82270	0.79209	0.76290	0.73503	0.70843	0.68301	0.65873	0.63552
5	0.98759	0.97537	0.96333	0.95147	0.92826	0.90573	0.88385	0.86261	0.82193	0.78353	0.74726	0.71299	0.68058	0.64993	0.62092	0.59345	0.56743
6	0.98513	0.97052	0.95616	0.94205	0.91454	0.88797	0.86230	0.83748	0.79031	0.74622	0.70496	0.66634	0.63017	0.59627	0.56447	0.53464	0.50663
7	0.98267	0.96569	0.94904	0.93272	0.90103	0.87056	0.84127	0.81309	0.75992	0.71068	0.66506	0.62275	0.58349	0.54703	0.51316	0.48166	0.45235
8	0.98022	0.96089	0.94198	0.92348	0.88771	0.85349	0.82075	0.78941	0.73069	0.67684	0.62741	0.58201	0.54027	0.50187	0.46651	0.43393	0.40388
9	0.97778	0.95610	0.93496	0.91434	0.87459	0.83676	0.80073	0.76642	0.70259	0.64461	0.59190	0.54393	0.50025	0.46043	0.42410	0.39092	0.36061
10	0.97534	0.95135	0.92800	0.90529	0.86167	0.82035	0.78120	0.74409	0.67556	0.61391	0.55839	0.50835	0.46319	0.42241	0.38554	0.35218	0.32197
11	0.97291	0.94661	0.92109	0.89632	0.84893	0.80426	0.76214	0.72242	0.64958	0.58468	0.52679	0.47509	0.42888	0.38753	0.35049	0.31728	0.28748
12	0.97048	0.94191	0.91424	0.88745	0.83639	0.78849	0.74356	0.70138	0.62460	0.55684	0.49697	0.44401	0.39711	0.35553	0.31863	0.28584	0.25668
13	0.96806	0.93722	0.90743	0.87866	0.82403	0.77303	0.72542	0.68095	0.60057	0.53032	0.46884	0.41496	0.36770	0.32618	0.28966	0.25751	0.22917
14	0.96565	0.93256	0.90068	0.86996	0.81185	0.75788	0.70773	0.66112	0.57748	0.50507	0.44230	0.38782	0.34046	0.29925	0.26333	0.23199	0.20462
15	0.96324	0.92792	0.89397	0.86135	0.79985	0.74301	0.69047	0.64186	0.55526	0.48102	0.41727	0.36245	0.31524	0.27454	0.23939	0.20900	0.18270
16	0.96084	0.92330	0.88732	0.85282	0.78803	0.72845	0.67362	0.62317	0.53391	0.45811	0.39365	0.33873	0.29189	0.25187	0.21763	0.18829	0.16312
17	0.95844	0.91871	0.88071	0.84438	0.77639	0.71416	0.65720	0.60502	0.51337	0.43630	0.37136	0.31657	0.27027	0.23107	0.19784	0.16963	0.14564
18	0.95605	0.91414	0.87416	0.83602	0.76491	0.70016	0.64117	0.58739	0.49363	0.41552	0.35034	0.29586	0.25025	0.21199	0.17986	0.15282	0.13004
19	0.95367	0.90959	0.86765	0.82774	0.75361	0.68643	0.62553	0.57029	0.47464	0.39573	0.33051	0.27651	0.23171	0.19449	0.16351	0.13768	0.11611
20	0.95129	0.90506	0.86119	0.81954	0.74247	0.67297	0.61027	0.55368	0.45639	0.37689	0.31180	0.25842	0.21455	0.17843	0.14864	0.12403	0.10367
21	0.94892	0.90056	0.85478	0.81143	0.73150	0.65978	0.59539	0.53755	0.43883	0.35894	0.29416	0.24151	0.19866	0.16370	0.13513	0.11174	0.09256
22	0.94655	0.89608	0.84842	0.80340	0.72069	0.64684	0.58086	0.52189	0.42196	0.34185	0.27751	0.22571	0.18394	0.15018	0.12285	0.10067	0.08264
23	0.94419	0.89162	0.84210	0.79544	0.71004	0.63416	0.56670	0.50669	0.40573	0.32557	0.26180	0.21095	0.17032	0.13778	0.11168	0.09069	0.07379
24	0.94184	0.88719	0.83583	0.78757	0.69954	0.62172	0.55288	0.49193	0.39012	0.31007	0.24698	0.19715	0.15770	0.12640	0.10153	0.08170	0.06588
25	0.93949	0.88277	0.82961	0.77977	0.68921	0.60953	0.53939	0.47761	0.37512	0.29530	0.23300	0.18425	0.14602	0.11597	0.09230	0.07361	0.05882
26	0.93714	0.87838	0.82343	0.77205	0.67902	0.59768	0.52623	0.46369	0.36069	0.28124	0.21981	0.17220	0.13520	0.10639	0.08391	0.06631	0.05252
27	0.93481	0.87401	0.81730	0.76440	0.66899	0.58586	0.51340	0.45019	0.34682	0.26785	0.20737	0.16093	0.12519	0.09761	0.07628	0.05974	0.04689

Present value table continues on next page



**Present value of \$1**

Periods	0.25%	0.50%	0.75%	1.00%	1.50%	2.00%	2.50%	3.00%	4.00%	5.00%	6.00%	7.00%	8.00%	9.00%	10.00%	11.00%	12.00%
28	0.93248	0.86966	0.81122	0.75684	0.65910	0.57437	0.50088	0.43708	0.33348	0.25509	0.19563	0.15040	0.11591	0.08955	0.06934	0.05382	0.04187
29	0.93015	0.86533	0.80518	0.74934	0.64936	0.56311	0.48866	0.42435	0.32065	0.24295	0.18456	0.14056	0.10733	0.08215	0.06304	0.04849	0.03738
30	0.92783	0.86103	0.79919	0.74192	0.63976	0.55207	0.47674	0.41199	0.30832	0.23138	0.17411	0.13137	0.09938	0.07537	0.05731	0.04368	0.03338
31	0.92552	0.85675	0.79324	0.73458	0.63031	0.54125	0.46511	0.39999	0.29646	0.22036	0.16425	0.12277	0.09202	0.06915	0.05210	0.03935	0.02980
32	0.92321	0.85248	0.78733	0.72730	0.62099	0.53063	0.45377	0.38834	0.28506	0.20987	0.15496	0.11474	0.08520	0.06344	0.04736	0.03545	0.02661
33	0.92091	0.84824	0.78147	0.72010	0.61182	0.52023	0.44270	0.37703	0.27409	0.19987	0.14619	0.10723	0.07889	0.05820	0.04306	0.03194	0.02376
34	0.91861	0.84402	0.77565	0.71297	0.60277	0.51003	0.43191	0.36604	0.26355	0.19035	0.13791	0.10022	0.07305	0.05339	0.03914	0.02878	0.02121
35	0.91632	0.83982	0.76988	0.70591	0.59387	0.50003	0.42137	0.35538	0.25342	0.18129	0.13011	0.09386	0.06763	0.04899	0.03558	0.02592	0.01894
36	0.91403	0.83564	0.76415	0.69892	0.58509	0.49022	0.41109	0.34503	0.24367	0.17266	0.12274	0.08754	0.06262	0.04494	0.03235	0.02335	0.01691
37	0.91175	0.83149	0.75846	0.69200	0.57644	0.48061	0.40107	0.33498	0.23430	0.16444	0.11579	0.08181	0.05799	0.04123	0.02941	0.02104	0.01510
38	0.90948	0.82735	0.75281	0.68515	0.56792	0.47119	0.39128	0.32523	0.22529	0.15661	0.10924	0.07646	0.05369	0.03783	0.02673	0.01896	0.01348
39	0.90721	0.82323	0.74721	0.67837	0.55953	0.46195	0.38174	0.31575	0.21662	0.14915	0.10306	0.07146	0.04971	0.03470	0.02430	0.01708	0.01204
40	0.90495	0.81914	0.74165	0.67165	0.55126	0.45289	0.37243	0.30656	0.20829	0.14205	0.09722	0.06678	0.04603	0.03184	0.02209	0.01538	0.01075
41	0.90269	0.81506	0.73613	0.66500	0.54312	0.44401	0.36335	0.29763	0.20028	0.13528	0.09172	0.06241	0.04262	0.02921	0.02009	0.01386	0.00960
42	0.90044	0.81101	0.73065	0.65842	0.53509	0.43530	0.35448	0.28896	0.19257	0.12884	0.08653	0.05833	0.03946	0.02680	0.01826	0.01249	0.00857
43	0.89820	0.80697	0.72521	0.65190	0.52718	0.42677	0.34584	0.28054	0.18517	0.12270	0.08163	0.05451	0.03654	0.02458	0.01660	0.01125	0.00765
44	0.89596	0.80296	0.71981	0.64545	0.51939	0.41840	0.33740	0.27237	0.17805	0.11686	0.07701	0.05095	0.03383	0.02255	0.01509	0.01013	0.00683
45	0.89372	0.79896	0.71445	0.63905	0.51171	0.41020	0.32917	0.26444	0.17120	0.11130	0.07265	0.04761	0.03133	0.02069	0.01372	0.00913	0.00610
46	0.89149	0.79499	0.70913	0.63273	0.50415	0.40215	0.32115	0.25674	0.16461	0.10600	0.06854	0.04450	0.02901	0.01898	0.01247	0.00823	0.00544
47	0.88927	0.79103	0.70385	0.62646	0.49670	0.39427	0.31331	0.24926	0.15828	0.10095	0.06466	0.04159	0.02686	0.01742	0.01134	0.00741	0.00486
48	0.88705	0.78710	0.69861	0.62026	0.48936	0.38654	0.30567	0.24200	0.15219	0.09614	0.06100	0.03887	0.02487	0.01598	0.01031	0.00668	0.00434
49	0.88484	0.78318	0.69341	0.61412	0.48213	0.37896	0.29822	0.23495	0.14634	0.09156	0.05755	0.03632	0.02303	0.01466	0.00937	0.00601	0.00388
50	0.88263	0.77929	0.68825	0.60804	0.47500	0.37153	0.29094	0.22811	0.14071	0.08720	0.05429	0.03395	0.02132	0.01345	0.00852	0.00542	0.00346

**End of present value table****Future value table begins on the next page**

**Future value of \$1**

Periods	0.25%	0.50%	0.75%	1.00%	1.50%	2.00%	2.50%	3.00%	4.00%	5.00%	6.00%	7.00%	8.00%	9.00%	10.00%	11.00%	12.00%
1	1.00250	1.00500	1.00750	1.01000	1.01500	1.02000	1.02500	1.03000	1.04000	1.05000	1.06000	1.07000	1.08000	1.09000	1.10000	1.11000	1.12000
2	1.00501	1.01003	1.01506	1.02010	1.03023	1.04040	1.05063	1.06090	1.08160	1.10250	1.12360	1.14490	1.16640	1.18810	1.21000	1.23210	1.25440
3	1.00752	1.01508	1.02267	1.03030	1.04568	1.06121	1.07689	1.09273	1.12486	1.15763	1.19102	1.22504	1.25971	1.29503	1.33100	1.36763	1.40493
4	1.01004	1.02015	1.03034	1.04060	1.06136	1.08243	1.10381	1.12551	1.16986	1.21551	1.26248	1.31080	1.36049	1.41158	1.46410	1.51807	1.57352
5	1.01256	1.02525	1.03807	1.05101	1.07728	1.10408	1.13141	1.15927	1.21665	1.27628	1.33823	1.40255	1.46933	1.53862	1.61051	1.68506	1.76234
6	1.01509	1.03038	1.04585	1.06152	1.09944	1.12616	1.15969	1.19405	1.26532	1.34010	1.41852	1.50073	1.58687	1.67710	1.77156	1.87041	1.97382
7	1.01763	1.03553	1.05370	1.07214	1.10984	1.14869	1.18869	1.22987	1.31593	1.40710	1.50363	1.60578	1.71382	1.82804	1.94872	2.07616	2.21068
8	1.02018	1.04071	1.06160	1.08286	1.12649	1.17166	1.21840	1.26677	1.36857	1.47746	1.59385	1.71819	1.85093	1.99256	2.14359	2.30454	2.47696
9	1.02273	1.04591	1.06956	1.09369	1.14339	1.19509	1.24886	1.30477	1.42331	1.55133	1.68948	1.83846	1.99900	2.17189	2.35795	2.55804	2.77308
10	1.02528	1.05114	1.07758	1.10462	1.16054	1.21899	1.28008	1.34392	1.48024	1.62889	1.79085	1.96715	2.15892	2.36736	2.59374	2.83942	3.10585
11	1.02785	1.05640	1.08566	1.11567	1.17795	1.24337	1.31209	1.38423	1.53945	1.71034	1.89830	2.10485	2.33164	2.58043	2.85312	3.15176	3.47855
12	1.03042	1.06168	1.09381	1.12683	1.19562	1.26824	1.34489	1.42576	1.60103	1.79586	2.01220	2.25219	2.51817	2.81266	3.13843	3.49845	3.89598
13	1.03299	1.06699	1.10201	1.13809	1.21355	1.29361	1.37851	1.46853	1.66507	1.88565	2.13293	2.40985	2.71962	3.06580	3.45227	3.88328	4.36349
14	1.03557	1.07232	1.11028	1.14947	1.23176	1.31948	1.41297	1.51259	1.73168	1.97993	2.26090	2.57853	2.92719	3.34173	3.79750	4.31044	4.88711
15	1.03816	1.07768	1.11860	1.16097	1.25023	1.34587	1.44830	1.55797	1.80094	2.07893	2.39656	2.75903	3.17217	3.64248	4.17725	4.78459	5.47357
16	1.04076	1.08307	1.12699	1.17258	1.26899	1.37279	1.48451	1.60471	1.87298	2.18287	2.54035	2.95216	3.42594	3.97031	4.59497	5.31089	6.13039
17	1.04336	1.08849	1.13544	1.18430	1.28802	1.40024	1.52162	1.65285	1.94790	2.29202	2.69277	3.15882	3.70002	4.32763	5.05447	5.89509	6.86604
18	1.04597	1.09393	1.14396	1.19615	1.30734	1.42825	1.55966	1.70243	2.02582	2.40662	2.85434	3.37993	3.99602	4.71712	5.55992	6.54355	7.68997
19	1.04858	1.09940	1.15254	1.20811	1.32895	1.45681	1.59865	1.75351	2.10685	2.52695	3.02560	3.61653	4.31570	5.14166	6.11591	7.26334	8.61276
20	1.05121	1.10490	1.16118	1.22019	1.34686	1.48595	1.63862	1.80611	2.19112	2.65330	3.20714	3.86968	4.66096	5.60441	6.72750	8.06231	9.64629
21	1.05383	1.11042	1.16989	1.23239	1.36706	1.51567	1.67958	1.86029	2.27877	2.78596	3.39956	4.14056	5.03383	6.10881	7.40025	8.94917	10.80385
22	1.05647	1.11597	1.17867	1.24472	1.38756	1.54598	1.72157	1.91610	2.36992	2.92526	3.60354	4.43040	5.43654	6.65860	8.14027	9.93357	12.10031
23	1.05911	1.12155	1.18751	1.25716	1.40838	1.57690	1.76461	1.97359	2.46472	3.07152	3.81975	4.74053	5.87146	7.25787	8.95430	11.02627	13.55235
24	1.06176	1.12716	1.19641	1.26973	1.42950	1.60844	1.80873	2.03279	2.56330	3.22510	4.04893	5.07237	6.34118	7.91108	9.84973	12.23916	15.17863
25	1.06441	1.13280	1.20539	1.28243	1.45095	1.64061	1.85394	2.09378	2.66584	3.38635	4.29187	5.42743	6.84848	8.62308	10.83471	13.58546	17.00006
26	1.06707	1.13846	1.21443	1.29526	1.47271	1.67342	1.90029	2.15659	2.77247	3.55567	4.54938	5.80735	7.39635	9.39916	11.91818	15.07986	19.04007
27	1.06974	1.14415	1.22354	1.30821	1.49480	1.70689	1.94780	2.22129	2.88337	3.73346	4.82235	6.21387	7.98806	10.24508	13.10999	16.73865	21.32488

Future value table continues on next page

**Future value of \$1**

Periods	0.25%	0.50%	0.75%	1.00%	1.50%	2.00%	2.50%	3.00%	4.00%	5.00%	6.00%	7.00%	8.00%	9.00%	10.00%	11.00%	12.00%
28	1.07241	1.14987	1.23271	1.32129	1.51722	1.74102	1.99650	2.28793	2.98970	3.92013	5.11169	6.64884	8.62711	11.16714	14.42099	18.57990	23.88387
29	1.07510	1.15562	1.24196	1.33450	1.53998	1.77584	2.04641	2.35657	3.18665	4.11614	5.41839	7.11426	9.31727	12.17218	15.86309	20.62369	26.74993
30	1.07778	1.16140	1.25127	1.34785	1.56308	1.81136	2.09757	2.42726	3.24340	4.32194	5.74349	7.61226	10.06266	13.26768	17.44940	22.89230	29.95992
31	1.08048	1.16721	1.26066	1.36133	1.58653	1.84759	2.15001	2.50008	3.37313	4.53804	6.08810	8.14511	10.86767	14.46177	19.19434	25.41045	33.55511
32	1.08318	1.17304	1.27011	1.37494	1.61032	1.88454	2.20376	2.57508	3.50806	4.76494	6.45339	8.71527	11.73708	15.76333	21.11378	28.20560	37.58173
33	1.08589	1.17891	1.27964	1.38869	1.63448	1.92223	2.25885	2.65234	3.64838	5.00319	6.84059	9.32534	12.67605	17.18203	23.22515	31.30821	42.09153
34	1.08860	1.18480	1.28923	1.40258	1.65900	1.96068	2.31532	2.73191	3.79432	5.25335	7.25103	9.97811	13.69013	18.72841	25.54767	34.75212	47.14252
35	1.09132	1.19073	1.29890	1.41660	1.68388	1.99989	2.37321	2.81386	3.94609	5.51602	7.68609	10.67658	14.78534	20.41397	28.10244	38.57485	52.79962
36	1.09405	1.19668	1.30865	1.43077	1.70914	2.03989	2.43254	2.89828	4.10393	5.79182	8.14725	11.42394	15.96817	22.25123	30.91268	42.81808	59.13557
37	1.09679	1.20266	1.31846	1.44508	1.73478	2.08069	2.49335	2.98523	4.26809	6.08141	8.63609	12.22362	17.24563	24.25384	34.00395	47.52807	66.23184
38	1.09953	1.20868	1.32835	1.45953	1.76080	2.12230	2.55568	3.07478	4.43881	6.38548	9.15425	13.07927	18.62528	26.43668	37.40434	52.75616	74.17966
39	1.10228	1.21472	1.33831	1.47412	1.78721	2.16474	2.61957	3.16703	4.61637	6.70475	9.70351	13.99482	20.11530	28.81598	41.14478	58.55934	83.08122
40	1.10503	1.22079	1.34835	1.48886	1.81402	2.20804	2.68506	3.26204	4.80102	7.03999	10.28572	14.97446	21.72452	31.40942	45.25926	65.00087	93.05097
41	1.10780	1.22690	1.35846	1.50375	1.84123	2.25220	2.75219	3.35990	4.99306	7.39199	10.90286	16.02267	23.46248	34.23627	49.78518	72.15096	104.21709
42	1.11057	1.23303	1.36865	1.51879	1.86885	2.29724	2.82100	3.46070	5.19278	7.76159	11.55703	17.14426	25.33948	37.31753	54.76370	80.08757	116.72314
43	1.11334	1.23920	1.37891	1.53398	1.89688	2.34319	2.89152	3.56452	5.40050	8.14967	12.25045	18.34435	27.36664	40.67611	60.24007	88.89720	130.72991
44	1.11612	1.24539	1.38926	1.54932	1.92533	2.39005	2.96381	3.67145	5.61652	8.55715	12.98548	19.62846	29.55597	44.33696	66.26408	98.67589	146.41750
45	1.11892	1.25162	1.39968	1.56481	1.95421	2.43785	3.03790	3.78160	5.84118	8.96501	13.76461	21.00245	31.92045	48.32729	72.89048	109.53024	163.98760
46	1.12171	1.25788	1.41017	1.58046	1.98353	2.48661	3.11385	3.89504	6.07482	9.43426	14.59049	22.47262	34.47409	52.67674	80.17953	121.57857	183.66612
47	1.12452	1.26417	1.42075	1.59626	2.01328	2.53634	3.19170	4.01190	6.31782	9.90597	15.46592	24.04571	37.23201	57.41765	88.19749	134.95221	205.70605
48	1.12733	1.27049	1.43141	1.61223	2.04348	2.58707	3.27149	4.13225	6.57053	10.40127	16.39387	25.72891	40.21057	62.58524	97.01723	149.79695	230.39078
49	1.13015	1.27684	1.44214	1.62835	2.07413	2.63881	3.35328	4.25622	6.83335	10.92133	17.37750	27.52993	43.42742	68.21791	106.71896	166.27462	258.03767
50	1.13297	1.28323	1.45296	1.64463	2.10524	2.69159	3.43711	4.38391	7.10668	11.46740	18.42015	29.45703	46.90161	74.35752	117.39085	184.56483	289.00219

End of future value table

End of exam paper

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**Financial Accounting & Reporting (1)  
2017 (FIN)**

# **Exam suggested solutions**

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## Question 1 (20 marks)

	\$
Draft profit before tax	4,000,000
Add: Legal compensation	<u>800,000</u>
Finalised profit before tax	4,800,000

Item	Explanation	Standard reference (a range of references would be acceptable)
Legal compensation	Adjusting event – Settlement of the lawsuit after the reporting date confirms that a receivable and gain should be recognised at 31 March 20X7, as the condition (patent infringement) existed at the reporting date	IAS 10 para. 8 or 9

Calculate the current tax liability for Darcina at 31 March 20X7

Worksheet to calculate the current tax liability at 31 March 20X7		
Item	\$	\$
Accounting profit before tax (as adjusted above)		4,800,000
1. Non-temporary difference adjustments		
Share-based payment expense <sup>1</sup>		51,000
2. Temporary difference adjustments		
Legal compensation	(800,000)	
Amortisation of software licence <sup>2</sup>	20,000	
Software licence tax deduction	(100,000)	
Consultancy services revenue <sup>3</sup>	(80,000)	
Consultancy services assessable for tax	120,000	
Annual leave expense	130,000	
Annual leave paid	(150,000)	
Share of associate's profit before tax <sup>4</sup>	(80,000)	
Assessable dividend received from Camby	<u>16,000</u>	
		<u>(924,000)</u>
<b>Taxable income</b>		<u>3,927,000</u>
<b>Current tax liability (at 30%)</b>		<u>1,178,100</u>

[Alternative layouts to the current tax liability calculation are acceptable]

**Workings****1. Share-based payment expense**

Year ended	Calculation	Remuneration expense for period \$	Equity balance \$
31.03.X6	$((8 - 0) \times 5,000 \times \$5.10 \times 1/3 \text{ years}) - \$0$	68,000	68,000
31.03.X7	$((8 - 1) \times 5,000 \times \$5.10 \times 2/3 \text{ years}) - \$68,000$	<b>51,000</b>	119,000

**2. Amortisation of software licence**

$(\$240,000 \div 36 \text{ months}) \times 3 \text{ months amortisation since operational} = \$20,000.$

**3. Consultancy services revenue**

$(\$120,000 \div 3 \text{ months}) \times 2 \text{ months revenue to be recognised based on performance obligations being satisfied over time} = \$80,000.$

**4. Share of associate's profit before tax**

Darcina's share is 40% of \$200,000 profit before tax = \$80,000.

**Learning outcomes**

Unit	Learning outcome
Unit 2	6. Explain and account for events after the reporting period
Unit 3	1. Identify, measure and recognise revenue from contracts with customers
Unit 4	2. Calculate and account for current tax
Unit 4	5. Explain and account for income tax expense
Unit 8	2. Explain and account for an intangible asset
Unit 14	1. Identify and account for share-based payments
Unit 17	1. Explain and account for an investment using the equity method



## Question 2 (20 marks)

Some candidates showed explanations item by item before preparing the statement presenting comprehensive income. Where a candidate correctly prepared only the statement itself, it is important to still support this with workings. A variety of responses were accepted here, allowing for candidates to prepare journal entries or written explanations for the amounts recognised. References to Accounting Standards were not required in this question but can serve as a quick summary of the accounting treatment.

### Item 1: Foreign currency receivable

Initial recognition at spot rate 15.02.X7 NZ\$350,000 × 0.96	\$336,000
Re-translation at closing rate as receivable is a monetary item:	
NZ\$350,000 × 0.98	\$343,000
<b>Gain</b> on foreign currency receivable (take to P&L)	\$7,000

### Item 2: Legal settlement

As the condition existed at balance date, this is an adjusting event under IAS 10. A provision should be recognised for \$5 million. This will reduce profit by \$5 million damages expense.

### Item 3: Cash flow hedge

The cumulative change in the fair value of swap asset since 31.03.X6 is \$13,150,000.

The cumulative change in the present value of future cash flows is \$12,920,000.

Applying IFRS 9 para. 6.5.11, the lower of these numbers, and hence the balance of the cash flow hedge reserve (CFHR), is \$12,920,000.

Given the question tells us this was correctly accounted for to 31.03.X6, there is \$12,800,000 already recognised in the CFHR, leaving a credit adjustment of \$120,000 to be recognised at 31.03.X7 in the CFHR.

The swap asset has increased in value. It must be adjusted by debit \$150,000. The balancing figure in this journal is the \$30,000 as hedge ineffectiveness which should be taken to P&L.

Date	Details	Dr \$	Cr \$
31.03. X7	Swap asset	150,000	
	Cash flow hedge reserve		120,000
	Hedge ineffectiveness (P&L)		30,000
To apply hedge accounting on the interest rate swap for the year ended 31 March 20X7.			

### Item 4: Revaluation of property, plant and equipment

Fair value	\$10,000,000
Carrying amount	\$11,000,000
Revaluation	\$1,000,000 decrement

This \$1,000,000 will be taken up by reducing the carrying value of the property, plant and equipment. The debit will be taken to OCI as a debit to the revaluation surplus, as it was reversing a prior increment. Tax has been ignored.

## Item 5: Reversal of impairment loss

<b>Step A</b>	
<b>Calculate the carrying amount at 31.03.X7 if no impairment write-down had occurred:</b>	
Amortisation: $80,000 \div 8 \text{ years} = \$10,000 \text{ p.a.}$	
Amortisation to 31.03.X7 is $2.5 \text{ years} \times \$10,000 = \$25,000$	
Carrying amount if impairment never occurred:	
Cost \$80,000 – amortisation \$25,000	<b>\$55,000</b>
<b>Step B</b>	
<b>Establish the recoverable amount under IAS 36:</b>	
Value in use (VIU) of \$58,000	
Fair value less cost of disposal (FVLCD) = $\$57,000 - \$1,000 = \$56,000$	
Therefore, the recoverable amount is the higher of these amounts (i.e. the VIU amount)	\$58,000
<b>Step C</b>	
<b>Establish the ceiling for an impairment reversal under IAS 36 para. 117</b>	
Lower of carrying amount if never impaired and recoverable amount	<b>\$55,000</b>
<b>Step D</b>	
<b>Impairment reversal calculation</b> (ceiling less carrying amount: $\$55,000 - \$48,400$ )	
	6,600
Recognised in <b>profit or loss</b> per IAS 36 para. 119	

<b>Adjusting profit for preparing the statement of comprehensive income</b>	
Calculation of adjusted profit figure	\$
Profit before adjustments	32,800,000
Gain on foreign exchange	7,000
Less Expense on provision for damages	(5,000,000)
Add Hedge ineffectiveness	30,000
Add Reversal of impairment loss	<u>6,600</u>
Adjusted profit figure	27,843,600

<b>KLIMA LIMITED</b>		
<b>Statement of comprehensive income for the year ended 31 March 20X7</b>		
		20X7 \$
<b>Profit</b>		<b>27,843,600</b>
<b>Other comprehensive income</b>		
<b>Items that will not be reclassified to profit or loss</b>		
Revaluation of property plant and equipment		(1,000,000)
<b>Items that may be reclassified subsequently to profit or loss</b>		
Cash flow hedges – effective portion		<u>120,000</u>
<b>Other comprehensive income</b>		<u>(880,000)</u>
<b>Total comprehensive income</b>		<b>26,963,600</b>

## Learning outcomes

Unit	Learning outcome
2	2. Prepare, analyse and explain a complete set of financial statements
2	6. Explain and account for events after the reporting period
5	1. Explain and account for foreign currency transactions and balances
7	2. Explain and account for property, plant and equipment during its useful life
8	2. Explain and account for an intangible asset
9	3. Explain and account for basic cash flow and fair value hedges
10	3. Explain and account for reversals of impairment losses

## Question 3 (20 marks)

### Part A (12 marks)

- (a) The convertible bond is a financial asset under IAS 32.

There are two tests to determine how the bond should be classified:

- SPPI test – the bond will deliver interest payments on specified dates. In addition, it will deliver principal repayment (delivered as either cash or shares) on a specified date. This means that it passes this test.
- Business model test – Nepoli is managing this bond as part of a portfolio that has the objective of return maximisation. This is achieved through both receiving contractual payments (interest and principal repayments) and also through buying and selling bonds.

The combined outcome from these two tests indicate that the bond should be classified as FVTOCI.

- (b) The bond should be recognised initially on 1 January 20X7 at fair value (\$7.2 million) plus transaction costs (\$50,000) (NB – not its face value as is currently in the general ledger). As it is classified as measured at FVTOCI, ongoing balances and interest received should be calculated using an effective interest rate method (EIM) table as follows:

Date	Opening balance	Principal repayments	Coupon interest <sup>1</sup>	Interest accrued using EIM <sup>2</sup>	Closing balance
	\$	\$	\$	\$	\$
1 January 20X7					7,250,000
30 June 20X7	7,250,000	0	(206,250)	252,880	7,296,630

1.  $5.5\% \times \$7,500,000 \times 6/12$

2.  $6.976\% \times \$7,250,000 \times 6/12$

The balance of the bond prior to revaluation at 30 June 20X7 is \$7,296,630. The fair value of the bond at 30 June 20X7 is \$7.4 million. This means a revaluation gain of \$103,370 will be disclosed in OCI (Dr Bond, Cr FVTOCI reserve).

Accordingly, the correct general ledger accounts at 30 June 20X7 are:

	Account no	Account description	Account balance	
			Debit	Credit
			\$	\$
Balance sheet	1-100	Bond investment	7,400,000	
Profit or loss	4-100	Interest received		252,880
Profit or loss	4-200	Loss on revaluation of investments	0	
OCI		FVTOCI reserve		103,370

- (c) The general approach should be adopted as there is no information to indicate that the investment is with a low credit risk entity (the low credit risk operational simplification cannot be adopted). There has been no increase in credit risk since acquisition so 12-month expected credit losses should be used to calculate impairment (Stage 1 of the general approach).

$$\text{ECL} = \$7,500,000 \times 1\% = \$75,000$$

Journal entry to record the impairment:

Date	Details	Dr \$	Cr \$
30 June 20X7	Impairment loss	75,000	
	FVTOCI reserve		75,000
Being recognition of the loss allowance for the Capri bond at 30 June 20X7 in profit or loss			

### Part B (8 marks)

The transaction price is \$2,300,000 including a \$100,000 project bonus.

- The project bonus is a form of variable consideration (IFRS 15 para. 51). Variable consideration can be determined using either the expected value or the most likely amount (IFRS 15 para. 53). Klipper has chosen to use the most likely amount, and there is a 55% likelihood of the bonus being achieved.
- Although the most likely scenario is that Klipper will receive the bonus, IFRS 15 para. 56 asks us to constrain our estimates of variable consideration, and consider whether it is highly probable that this bonus will not need a significant reversal in future.
- Klipper's achievement of the bonus is dependent on two factors that are beyond Klipper's control: the shipping of parts and the weather. These factors are specifically discussed in IFRS 15 para. 57 and can make a reversal more likely.
- On this basis, it is unlikely to achieve the 'highly probable' hurdle, and the estimate should be constrained to zero given its binary nature.
- IFRS 5 defines highly probable as significantly more likely than probable. The Standard does not provide a percentage; however, it is unlikely that 55% achieves this.

### Recognition calculations:

Performance obligation	Stand-alone \$	%	Allocation \$	Performance obligation met?
Maintenance	1,600,000	62.6%	1,377,200	Over time (12 months) 3 months to recognise
Installation	955,555	37.4%	822,800	Obligation not yet met
Total	2,555,555		2,200,000	\$344,300 to recognise

### Learning outcomes

Unit	Learning outcome
3	1. Identify, measure and recognise revenue from contracts with customers
9	1. Explain and identify financial instruments and the principles for classifying them as financial assets, financial liabilities or equity instruments of the issuer
9	2. Account for financial assets, financial liabilities, and equity instruments of the issuer (including derivatives)
9	4. Explain and account for impairment of financial assets

## Question 4 (20 marks)

### Part A (10 marks)

Calculation of lease liability at the commencement date			
Date	Payment \$	PV factor (8%)	PV cash flow \$
1 July 20X6	100,000	1.0000	100,000
1 July 20X7	100,000	0.9259	92,590
1 July 20X8	100,000	0.8573	85,730
1 July 20X9	100,000	0.7938	79,380
1 July 20Y0	100,000	0.7350	73,500
Lease liability			431,200

Or  $\$100,000 + (\$100,000 \times 3.3121) = \$431,210$

(any rounding issues were accepted by the marking panel)

Date	Details	Dr \$	Cr \$
01.07.X6	Right-of-use asset	431,200	
	Lease liability		431,200
To record the lease liability and the right-of-use asset for the underlying asset being leased			

Date	Details	Dr \$	Cr \$
01.07.X6	Lease liability	100,000	
	Cash		100,000
To record the lease payment made in advance on the commencement of the lease			

Date	Details	Dr \$	Cr \$
01.07.X6	Insurance expense <sup>1</sup>	5,000	
	Cash		5,000
To record the insurance premium over the underlying asset			

<sup>1</sup> Recognising the \$5,000 to a prepayments account was also accepted by the exam panel. The insurance should be expensed and should not be capitalised into the right of use asset as an initial direct cost.

Date	Details	Dr \$	Cr \$
30.06.X7	Interest expense	26,496	
	Lease liability / accrued interest		26,496
To record the interest accrued on the lease liability up to 30 June 20X7 ( $\$331,200 \times 8\%$ )			

Date	Details	Dr \$	Cr \$
30.06.X7	Depreciation expense	86,240	
	Accumulated depreciation		86,240
To record the annual depreciation of the right-of-use asset over the five-year useful life of the underlying asset (machine) ( $\$431,200 \div 5$ )			

**Part B (10 marks)**

(a)

Date	Details	Dr \$	Cr \$
30.06.X7	Share capital <sup>1</sup>	3,300,000	
	Retained earnings b/f <sup>2</sup>		1,100,000
	Gain from a bargain purchase (profit or loss) <sup>3</sup>		300,000
	Investment in Snappy		1,900,000
To eliminate Petrie's share of the pre-acquisition equities of Snappy which are reflected in the cost of the investment			

- \$6,000,000 × 55% share.
- \$2,000,000 × 55% share of pre-acquisition losses.
- \$300,000 gain from a bargain purchase recognised on consolidation in the year of acquisition.

Date	Details	Dr \$	Cr \$
30.06.X7	Management fee revenue	400,000	
	Management fee expense		400,000
To eliminate the management fee			

Date	Details	Dr \$	Cr \$
30.06.X7	Loan payable	400,000	
	Loan receivable		400,000
To eliminate the intragroup loan arising from the unpaid management fee			

Date	Details	Dr \$	Cr \$
30.06.X7	Sales	110,000	
	Cost of sales		110,000
To eliminate the intragroup sales and purchases			

Date	Details	Dr \$	Cr \$
30.06.X7	Cost of sales	30,000	
	Inventory		30,000
To eliminate the unrealised profit on the inventory sale			

Date	Details	Dr \$	Cr \$
30.06.X7	Deferred tax asset	9,000	
	Income tax expense		9,000
To recognise the tax effect on the elimination of the unrealised profit			

(b)

Item	Impact on NCI?	Explanation
Intragroup sales	No	The NCI is not adjusted as there is no unrealised profit impact
Unrealised profit in closing inventory	Yes	The partly owned subsidiary made the sale, therefore the NCI is adjusted
Management fee	No	The NCI is not adjusted as there is no unrealised profit impact
Intragroup loan relating to management fee	No	The NCI is not adjusted as there is no unrealised profit impact / there is only a balance sheet impact

*The majority of candidates did not recognise all components of these potential NCI impacts. Markers allowed for a variety of responses and focused on one correct identification per item.*

## Learning outcomes

Unit	Learning outcomes
4	3. Calculate and account for deferred tax.
7	2. Explain and account for property, plant and equipment during its useful life.
12	2. Explain and account for lease transactions (for lessees).
15	2. Explain and account for a business combination in the books of the acquirer.
16	4. Explain and account for a consolidation for a partly-owned subsidiary.