SECTION A

QUESTION 1.

Kabelo Co is the parent company of a group whose financial year end is 31 December 20X5.

The following **exhibits**, available on the left-hand side of the screen, provide information relevant to the question:

1. Acquisition of Trudos Co – provides information regarding the acquisition of Trudos Co and other information relevant to complete the consolidated statement of cash flows.
2. Financial instruments – contains information about a number of financial instruments held by the Kabelo Group.
3. Consolidated statements – this includes the draft extracts for the consolidated statement of cash flows together with extracts from the finalised consolidated statement of financial position for the year ended 31 December 20X5 including comparative figures.

EXHIBIT 1. Acquisition of Trudos Co

Kabelo Co acquired 80% of the 100,000 equity shares of Trudos Co on 30 June 20X5. The consideration consisted of a cash payment of $5 per share acquired and an issue of one Kabelo Co $1 equity share for every four shares acquired in Trudos Co. Kabelo Co's policy is to value non-controlling interest at fair value at the date of acquisition. The fair value of Kabelo Co's and Trudos Co's shares on 30 June 20X5 were $13 and $8 respectively.

The carrying amount of the net assets reported by Trudos Co on 30 June 20X5 were as follows:

	$
Property, plant and equipment	421,000
Inventories	256,800
Trade receivables	220,300
Cash and cash equivalents	24,900
Trade payables	(175,400)
Total	747,600

The only fair value adjustment on acquisition related to plant which had a fair value of $50,000 above its carrying amount.

The group pays tax at 30% and deferred tax was correctly accounted for within the consolidated statement of financial position. The taxation figure in the statement of profit or loss for the year ended 31 December 20X5 is $385,600 and this figure has been included as taxation paid within the draft statement of cash flows.

The group's financial controller has accurately completed the consolidated statement of financial position and consolidated statement of profit or loss and other comprehensive income but the consolidated statement of cash flow is in draft. The financial controller has not yet considered the impact of the acquisition of Trudos Co on the consolidated statement of cash flow.

The statement of cash flows figures for movements in inventories, trade receivables, trade payables and property, plant and equipment have been calculated by considering simply the differences in the year-end balances in the consolidated statement of financial position from 31 December 20X4 and 31 December 20X5.

Goodwill of Trudos Co was impaired during the year. There were no other goodwill impairments within the group.

The depreciation charge of the group for the year ended 31 December 20X5 was $625,060.

There were no disposals of non-current assets by the group during the year although there were some additions paid for by cash.

EXHIBIT 2. Financial instruments

The Kabelo Group has a number of financial instruments presented within its consolidated statement of financial position.

Some group entities which had surplus cash resources had acquired debentures in other non-group entities to increase returns. Other group entities had raised finance by issuing bonds.

Kabelo Co financed the acquisition of Trudos Co by acquiring a bank loan.

Kabelo Co also had an overdrawn bank balance as at 31 December 20X5. The overdrawn bank balance fluctuates regularly from an in-funds balance to an overdrawn balance.

EXHIBIT 3. Consolidated statements

	A	B	C
1			
2	The extracts below have been replicated in the pre-populated spreadsheet response option.		
3			
4	**Draft extracts from the consolidated statement of cash flows for the Kabelo Group for**		
5	**the year ended 31 December 20X5:**		
6			
7	**Cash inflow from operating activities:**	**$**	
8	Profit before taxation	1,318,100	
9	Depreciation	625,060	
10			
11	Increase in inventories	-658,100	
12	Increase in trade and other receivables	-211,500	
13	Increase in trade and other payables	93,900	
14			
15	**Cash generated from operations**	**1,167,460**	
16	Taxation paid	-385,600	

	A	B	C
18	**Cash inflow from operating activities**	**781,860**	
19			
20	**Cash-flow from investing activities**		
21	Acquisition of property, plant and equipment	-543,600	
22	Consideration paid for acquisition of Trudos Co	(not yet calculated)	
23			
24	**Cash outflow from investing activities**	**-543,600**	
25			
26	**Extracts from the consolidated statement of financial position of the Kabelo Group:**		
27			
28		**31 December 20X5**	**31 December 20X4**
29		**$**	**$**
30	Property, plant and equipment	3,668,900	3,125,300
31	Goodwill	447,400	441,100
32	Deferred tax liability	130,000	250,000
33	Current tax liability	364,300	256,900

REQUIREMENTS (30 MARKS)

(a) Using exhibit 1:

(i) adjust the pre-populated spreadsheet to prepare revised extracts for the operating and investing activities of the consolidated statement of cash flows for the Kabelo Group for the year ended 31 December 20X5; and

(14 marks)

(ii) explain the adjustments required to correct the operating and investing activities of the consolidated statement of cash flows for the Kabelo Group for the year ended 31 December 20X5.

(10 marks)

(b) Using exhibit 2, advise the financial controller as to how the various financial instruments, including the overdraft, should be presented in the consolidated statement of cash flows.

(6 marks)

QUESTION 2.

Dario Co is a pharmaceutical company. The financial year end of Dario Co is 31 December 20X7. The following **exhibits**, available on the left-hand side of the screen, provide information relevant to the question:

1. Ethical considerations – describes the ethical issues surrounding Dario Co.
2. Operating segments – describes the potential operating segments in Dario Co.

EXHIBIT 1. Ethical considerations

The finance director (FD) of Dario Co is not a permanent employee but is paid on a consultancy basis. He is currently on a six-month contract. The chief executive officer (CEO) is a personal friend of the FD and she recommended him to the board of Dario Co. The FD and the CEO are both ACCA members.

Dario Co currently has a cash flow problem, and the CEO has asked the FD if he is prepared to reduce his current fee by 50%. The FD's contract is due for renewal in the next month. The CEO has recently spoken to the FD and stated that his contract is more likely to be renewed if he is prepared to take a fee reduction. She has also said that if he needs support, then as a friend, she will help him.

The FD is upset by the fee request as no other director has taken a cut in their salary. He is currently undertaking a going concern review of Dario Co, but has decided not to complete his report until he has considered his position with Dario Co.

The FD's findings will also form part of a submission to the government for funding and will be shared with the external auditors. He knows that the current cash flow position would indicate that the company is not a going concern and that if he submitted his report, there would be no government funding. There is also the possibility that the financial statements would receive a qualified audit report. He is considering overstating future potential returns on investments.

In addition, many of the accounting staff are remote employees, meaning that they are now working at home rather than working in the office. The FD is worried about the possibility of data theft. Unfortunately, he does not have the skills, nor does Dario Co have the capacity, to undertake a widespread investigation into the issue. Given the current request to reduce his fee and the cash flow situation, he also does not have the incentive to deal with the potential data theft or inform the board to enable them to address any potential problem. However, he has asked the information technology department to add productivity monitoring software to all remote employees' computers without their permission or knowledge and any employee who spends time on non-business websites will be immediately disciplined.

EXHIBIT 2. Operating segments

Dario Co has four divisions (A, B, C and D).

Divisions A and B produce and sell to third parties. Division A produces vaccines and sells them to governments, generating 60% of Dario Co's total revenue. Division B produces allergy testing kits and sells them to pharmacy wholesalers, generating 20% of Dario Co's total revenue. Division B's long-term average gross profit margin is significantly higher than division A's.

Divisions C and D undertake research and development. Division C does not provide any research and development services to third parties and only conducts activities for divisions A and B. Division C does not generate revenue from any internal or external source. It is purely a cost centre operating from division D's premises.

Division D performs contract investigation activities for other laboratories and pharmaceutical companies. The external revenues of this division represent 20% of Dario Co's total revenues.

The operating results for divisions A, B, and D are regularly reviewed by the CEO. These results include separate divisional operating profit or loss statements, from which operational decisions are made. The costings and budgets for division C are also reviewed by the CEO.

There are four divisional heads who are directly accountable to the CEO and these heads regularly discuss the operating activities including the research and development activities, financial results, forecasts and plans for their division.

The CEO is the chief operating decision maker.

REQUIREMENTS (20 MARKS)

(a) Using exhibit 1, discuss the ethical issues caused by the current business situation.

(10 marks)

Professional marks will be awarded in part (a) for the identification of relevant ethical principles and the application of these to the scenario.

(2 marks)

(b) Explain, in accordance with the principles of IFRS 8 *Operating Segments*, whether divisions A, B, C and D should be treated as separate reportable segments. Your explanation should cover:

- **the definition of an operating segment;**
- **the aggregation of operating segments; and**
- **the identification of reportable segments.**

(8 marks)

SECTION B

QUESTION 3.

Jacinta Co is the parent company of a group. Its main business is in the telecommunications sector but, with the continued expansion of products and services, it has also developed a credit risk management business. The financial year end is 31 December 20X6. The functional and presentation currency of Jacinta Co and Jacinta Group is the dollar.

The following **exhibits**, available on the left-hand side of the screen, provide information relevant to the question:

1. Loan portfolio – describes the purchase of credit-impaired loans by Jacinta Co.
2. Revenue and inventories – describes a two-year service agreement with Sear Co and the sale of inventories to an overseas subsidiary.

EXHIBIT 1. Loan portfolio

Jacinta Co purchases credit-impaired loans and measures these at amortised cost. Jacinta Co correctly calculates the loss allowance as the changes in lifetime expected credit losses since initial recognition of the asset which is effectively the changes in the estimated cash flows.

On 1 January 20X6, Jacinta Co bought credit-impaired loans with a remaining term of four years. Jacinta Co paid $32 million, which is equivalent to the fair value.

At 1 January 20X6, the remaining contractual cash flows expected to be received on 31 December each year are:

Year	20X6	20X7	20X8	20X9
	$m	$m	$m	$m
Expected cash flows	8·8	8·8	8·8	8·8

The credit-adjusted effective interest rate on the above cash flows is 3·9% per annum.

During the year ended 31 December 20X6, $8·8 million was collected. At 31 December 20X6, the credit worthiness of the loans has improved. Jacinta Co now expects the following cash flows to be collected:

Year	20X7	20X8	20X9
	$m	$m	$m
Expected cash flows	10	10	10

EXHIBIT 2. Revenue and inventories

Revenue from Sear Co

On 1 January 20X6, Jacinta Co entered into a contract to provide Sear Co with an internet service for two years. The contract price was agreed at $2 million which was received in full on 1 January 20X6. At the same date, Jacinta Co sold equipment to Sear Co at its fair value of $500,000. At the end of the internet service contract, on 31 December 20X7, Sear Co has a right to return the equipment to Jacinta Co and receive $20,000. Jacinta Co anticipates that the equipment's fair value will be $75,000 in two years' time.

The market for second-hand equipment is very strong and Sear Co would be able to sell the equipment easily at the end of the two-year agreement. Jacinta Co does not want to deal in second-hand equipment and therefore always prices equipment returns at an amount substantially below fair value. Sear Co has never returned equipment to Jacinta Co in the past.

Sale of inventories to overseas subsidiary

On 1 September 20X6, Jacinta Co sold inventories costing $1·35 million to a wholly-owned overseas subsidiary for $2 million. There is no right of return.

The subsidiary has the euro (€) as its functional currency. The exchange rate on the date of the sale from Jacinta Co to the overseas subsidiary was $1 = €1·25. At 31 December 20X6, the subsidiary still holds the goods in inventories and the exchange rate is $1 = €1·30. There is no intercompany debt outstanding at the year end.

REQUIREMENTS (25 MARKS)

(a) Explain how Jacinta Co should account for the credit-impaired loans in the financial statements for the year ended 31 December 20X6. Your answer should include journal entries.

(8 marks)

(b)(i) Explain how the revenue from the internet service contract and the sale of equipment to Sear Co should be accounted for in accordance with IFRS 15 *Revenue from Contracts with Customers.*

(10 marks)

(b)(ii) Explain, with calculations, how the sale of inventories would be accounted for in the individual financial statements of both Jacinta Co and the overseas subsidiary at 1 September 20X6 and in the consolidated financial statements of the Jacinta Group at 31 December 20X6.

(7 marks)

QUESTION 4.

Benito Co is in the real estate industry. The financial year end of Benito Co is 31 December 20X7.

The following **exhibit**, available on the left-hand side of the screen, provides information relevant to the question:

1. Sale and leaseback – describes a sale and leaseback transaction with Otine Co, and the key performance indicators that are affected by the sale and leaseback.

EXHIBIT 1. Sale and leaseback

(a) In accordance with IFRS Accounting Standards:

(i) describe how an entity assesses whether the transfer of an asset qualifies as a 'sale' in sale and leaseback accounting;

(ii) explain how sale and leaseback transactions are dealt with by the seller-lessee in accordance with IFRS 16 *Leases*, if the transfer of an asset qualifies as a 'sale';

(iii) explain how sale and leaseback transactions are dealt with by the seller-lessee, if the transfer of an asset does not qualify as a 'sale'; and

(iv) explain the effect on the accounting treatment if a sale and leaseback agreement contains a call option under which the seller-lessee can, at its option, repurchase the property.

Note: There is no need to refer any exhibit to answer part (a).

(9 marks)

(b) Using exhibit 1, explain in accordance with IFRS 16, the accounting entries for the sale and leaseback transaction in the financial statements of Benito Co on 1 January 20X7 if the head office transfer:

- **qualifies as a 'sale'; and**
- **does not qualify as a 'sale'.**

(7 marks)

(c) Using exhibit 1, compare the impact of the head office transfer qualifying as a 'sale' and not qualifying as a 'sale' on Benito Co's financial statements and key performance indicators (KPIs).

(7 marks)

Two professional marks will be awarded in part (c) for the quality of the discussion regarding the effects on the financial statements and the specific KPIs.

(2 marks)