SECTION A

QUESTION 1.

Sterling Co is currently preparing its individual and consolidated financial statements for the year ended 31 March 20X9 in accordance with International Financial Reporting Standards.

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

1. Acquisition of Berthold Co - describes the purchase of 40% of Berthold Co on 1 January 20X7 and the further acquisition of 35% on 1 December 20X8.
2. Investment in Malting Co - describes the purchase of 30% of Malting Co on 1 July 20X8.
3. Batch Co: discontinued operation - describes the acquisition of Batch Co which Sterling Co decides to sell on 1 January 20X9.

EXHIBIT 1. Acquisition of Berthold Co

Sterling Co paid $25 million for 40% of Berthold Co's 10 million $1 ordinary shares on 1 January 20X7 when Berthold Co's retained earnings were $18 million. Berthold Co has no other reserves. Sterling Co exercised significant influence over Berthold Co's financial and operating policy decisions.

A further 35% stake in Berthold Co was acquired on 1 December 20X8 for $41 million, when the fair value of Berthold Co's identifiable assets and liabilities was $55·3 million, and Berthold Co's retained earnings were $42·3 million. The difference between the fair value of the identifiable assets and liabilities of Berthold Co and their carrying amounts related to non-depreciable land. The market price of Berthold Co's shares just prior to 1 December 20X8 was $9·20 per share. Sterling Co measures non-controlling interest at fair value at the date of acquisition. Goodwill at 31 March 20X9 is not impaired.

Berthold Co reported a profit for the year ended 31 March 20X9 of $11·1 million.

EXHIBIT 2. Investment in Malting Co

On 1 July 20X8, Sterling Co paid cash of $2·5 million and issued loan notes with a nominal value of $1·1 million and a fair value of $1·3 million to acquire 30% of the equity interest of Malting Co. The remaining 70% of the equity in Malting Co is owned equally between two unrelated companies. All key operating decisions require unanimous consent of all three investing parties. Each of the three investing parties has the right to its share of the net assets of Malting Co via a contractual agreement. Malting Co reported a loss of $0·8m for the year ending 31 March 20X9 and a dividend was neither paid nor proposed. Because of the poor performance in the year, all three investing parties provided separate guarantees to Malting Co's bank.

EXHIBIT 3. Batch Co: discontinued operation

On 1 January 20X9, Sterling Co announced a plan to dispose of Batch Co, which operates in a significantly different business sector to the rest of the group.

Sterling Co first acquired 70% of the equity shares in Batch Co on 1 January 20X7 for consideration of $3·1 million when the fair value of the identifiable net assets acquired was $3·6 million. The ordinary share capital and retained earnings of Batch Co were $0·5 million and $2·1 million respectively. The excess of the fair value of the identifiable net assets was due to a building with an estimated useful life of 10 years at the acquisition date. The fair value of the non-controlling interest (NCI) in Batch Co was $0·9 million on 1 January 20X7. Sterling Co uses fair values to measure NCI.

On 1 January 20X9, Batch Co reported retained earnings of $2·9 million, with no change in ordinary share capital, or impairment of goodwill, since acquisition.

Sterling Co decided to treat Batch Co as a disposal group held for sale in accordance with IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*. Assets and liabilities of Batch Co require no remeasurement to meet applicable IFRS standards prior to restating as a disposal group, and the total fair value less costs to sell of the disposal group at 1 January 20X9 was estimated to be $4·4 million.

REQUIREMENTS (30 MARKS)

(a) Using exhibit 1:

(i) explain how Berthold Co will be accounted for, including calculations, in Sterling Co's consolidated Statement of Profit or Loss for the year ended 31 March 20X9; and

(8 marks)

(ii) explain and show how the goodwill in Berthold Co would be calculated at 1 December 20X8.

(6 marks)

(b) Using exhibit 2, advise the directors of Sterling Co, with illustrative calculations, how the 30% investment in Malting Co should be accounted for in Sterling Co's individual and consolidated financial statements.

(7 marks)

(c) Using exhibit 3, explain to the directors of Sterling Co how to account for Batch Co as a discontinued operation at 1 January 20X9 in Sterling Co's consolidated financial statements. Your answer should include:

- **a calculation of the goodwill at 1 January 20X7; and**
- **a calculation of how the investment in Batch Co should be measured prior to disposal.**

(9 marks)

QUESTION 2.

Jassie Co operates in the oil and gas industry. The current financial year end of Jassie Co is 31 December 20X7.

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

1. Granting of licences - describes the process of granting licences to customers.
2. Ethical issues - describes the potential ethical issues surrounding the working practices of the finance director.

EXHIBIT 1. Granting of licences

Jassie Co provides services to customers to help them evaluate whether there are potential oil reserves in a particular geographical location. Customers generally enter into the contract before the survey process commences and eventually purchase a licence to search for oil deposits.

Service phase

During the service phase, Jassie Co collects site data over the first year of the contract, then processes and analyses the data over the next six months. The area surveyed is determined by Jassie Co who is the only decision-maker and the owner of both the data and the land being surveyed. All of the data is made available to customers in the final survey report. Customers cannot process the data or obtain a licence other than by Jassie Co's approval. The value to the customer is in the granting of the licence and not in the data.

As data is being collected and processed, presentations and reports are given to customers to indicate the potential of an area. Customers have ongoing access to the data during collection and processing. When the final report is made available, the customer decides whether to invest in the area.

Granting of licence

The customers can exit the contract on receipt of the report but the total price of the contract, including the price of the final licence, is still payable to Jassie Co. In practice, no customer leaves the contract at this stage. The licence is granted at this stage and once the licence has been granted, there is no further analysis or service provided to the customer.

The directors of Jassie Co concluded that the company has only one performance obligation, being the granting of a licence at the end of a survey. This is because the collection and processing of the data (service phase) is a component of the granting of the licence and cannot be distinguished from the licence. In addition, the service phase alone is of no benefit on its own. The final licence provided to the customer is based upon the data collected and processed during the service phase.

EXHIBIT 2. Ethical issues

Jassie Co uses Big Data analytics and various algorithms in order to indicate the potential of finding oil in a particular geographical location. The chief data officer understands the science and statistics, and can explain outcomes simply and clearly to customers. The finance director, Mr Betso, who is ACCA qualified, has little knowledge of the technology involved. He feels that the technology used is too complex and there is no need for him to understand it as long as the chief data officer understands it. The chief data officer reports to the finance director.

Recently, the outcome of one set of data showed that there was little chance of oil being found on one of the sites but the finance director insisted that the data was run again to include historical data which would then indicate a more favourable outcome for a customer, Olio Co.

Mr Betso has a friend, Ms Stylos, who works as the accountant at Olio Co. Ms Stylos has asked Mr Betso for advice as to how to account for the licence granted to Olio Co. Mr Betso suggested that Ms Stylos use IFRS 16 *Leases* as it is a right-to-use licence. In addition, Mr Betso knew that Ms Stylos held shares in Olio Co and suggested to her that the share price of Olio Co was likely to fall because there was little chance of oil being found as a result of the granting of the licence.

REQUIREMENTS (20 MARKS)

(a) Discuss:

- **whether revenue from the service phase and the grant of a licence to a customer are separate performance obligations or a single performance obligation; and**
- **whether the revenue should be recognised at a point in time in accordance with IFRS 15 *Revenue from Contracts with Customers.***

(8 marks)

(b) Explain the ethical issues for the finance director, Mr Betso, setting out how the issues may be resolved.

(10 marks)

Professional marks will be awarded in part (b) for the quality of the discussion regarding the resolution of the ethical issues.

(2 marks)

SECTION B

QUESTION 3.

Rubul Co is a group which manufactures furniture and is currently preparing its financial statements for the year ended 31 December 20X7.

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

1. Consignment arrangement - describes the sale and despatch of garden furniture to garden centres and its inclusion in the financial statements.
2. Provision for tax liability - describes the basis of the calculation of sales and income tax liabilities for the current and previous years.
3. Historic exchange rate - describes the use of the historic exchange rate which is not updated to disclose financial statement movements.

EXHIBIT 1. Consignment arrangement

Rubul Co provides garden centres with furniture on a consignment basis. Rubul Co retains legal title to the furniture until they are sold by the garden centre to a customer. The products are immediately available for sale on delivery to the garden centres. The garden centre does not have any obligation to pay Rubul Co until a sale to a customer occurs. Physical possession remains with the garden centre unless the furniture is sold or returned to Rubul Co. Rubul Co also retains the right to have any unsold furniture returned to them, or to transfer unsold products to another retailer. Once the garden centre has sold the furniture, Rubul Co has no further obligations. The garden centres then remit to Rubul Co the sales proceeds net of their agent's commission.

Rubul Co has decided to include the sales value of all furniture delivered to and held by garden centres in revenue.

EXHIBIT 2. Provision for tax liability

Sales tax

Rubul Co has shipped and sold goods in an overseas country for ten years. Rubul Co was under the impression that the sales in the overseas country are subject to sales tax if the company had a physical **and** economic presence in the country. Rubul Co had always understood that because it did not have a physical presence in the country, it was exempt from sales tax. However, the tax law stated that companies were subject to sales tax if they had a physical **or** economic presence. Therefore, at 31 December 20X7, Rubul Co has realised that a liability for sales tax has existed for the previous ten years.

Rubul Co has never collected sales tax or filed sales tax returns in the overseas country. Rubul Co has never been contacted regarding sales tax by the tax authorities in the overseas country. Rubul Co therefore considers that the risk of detection by the taxation authorities is very low. However, if the taxation authorities knew about Rubul Co's activities, it is probable that Rubul Co would be liable for uncollected sales taxes, interest and penalties.

Rubul Co considers that the tax authorities would settle for an amount less than the full liability if full disclosure was made as it is 'widely understood' that the taxation authority would look back no more than seven years to determine the amount of sales tax due. The tax authorities can reclaim any sales tax liability from prior years.

Income tax

On 31 December 20X7, legal proceedings were started against Rubul Co by the tax authorities in the same overseas country for unpaid income tax. Rubul Co disputes the fact that it owes income tax as it has always paid this tax on time. Rubul Co considers that it is just coincidence that these proceedings have commenced and does not relate to the sales tax issue. Rubul Co considers that there is little chance of the income tax case succeeding. In any event, Rubul Co considers that it cannot measure any potential income tax liability as in its opinion none exists.

EXHIBIT 3. Historic exchange rate

Rubul Co has substantial deposits in currencies other than its functional currency. It also has a number of overseas subsidiaries where the local currency is used to prepare the financial statements which are then translated into the presentation currency under IAS 21 *The Effects of Changes in Foreign Exchange Rates*. These countries often suffer fluctuations in exchange rates, so Rubul Co decided to eliminate the effect of exchange rate differences and presented financial information using a single historic fixed exchange rate for the translation of the international subsidiaries, which is not updated between periods.

REQUIREMENTS (25 MARKS)

(a) Explain, in accordance with IFRS 15 *Revenue from Contracts with Customers,* how the consignment arrangement should be dealt with in the financial statements of Rubul Co and explain why the proposed treatment of revenue is not in accordance with IFRS 15.

(7 marks)

(b) Assess whether Rubul Co should create a provision in accordance with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* for its sales tax and income tax liabilities in the financial statements for the year ended 31 December 20X7.

(10 marks)

(c) Discuss:

- **the advantages for the users of the financial statements of applying a single historic fixed exchange rate in the financial statements of Rubul Co;**
- **whether this is acceptable practice under IFRS standards; and**
- **whether it would enhance the usefulness of the financial statements if the foreign exchange gains or losses on Rubul Co's overseas deposits were recognised in other comprehensive income.**

(8 marks)

QUESTION 4.

Juan Co is a group of companies which operates in the energy industry. The financial year end of the company is 31 December 20X7.

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

1. Climate change issues - outlines the issues which Juan Co currently faces due to the impact of climate change.

This information should be used to answer the question **requirements** within the **response option** provided.

EXHIBIT 1. Climate change issues

Juan Co has several coal-fired power plants and is currently facing challenges dealing with the impact of climate change. Juan Co has not considered the effect of climate change when preparing the current financial statements.

There has been a decline in the demand for the energy from Juan Co's coal-fired plants because of the volume of greenhouse gases emitted by the plants. The company is committed to meeting the expanding climate change regulations of its jurisdiction relating to emissions. If a company does not meet the jurisdiction's climate-related targets, then fines are imposed by the government for this failure. Juan Co is also considering a restructure to achieve eco-design of its products and services and to improve the energy efficiency of its existing buildings.

As a result, Juan Co has had to change and adapt its business activities and operations, including increased expenditure on research and development. The company has revised its assumptions about future profitability and cash flows based upon it cutting its emissions. If it does not cut emissions, it will risk losing many customers.

Juan Co's supply chains are becoming more complex and globally spread with many points of possible failure. Juan Co has subsidiaries in regions of the world which are subject to weather extremes and anticipates some physical harm to its property, plant and equipment because of this. There is the likelihood that some of the power plants will require decommissioning sooner than expected which will mean restoring the land damage. Some restoration work may not be possible at the level required by regulatory changes.

Corporate risk is increasing due to environmental damage caused by climate change.

Investors are worried about their share value in Juan Co because of an anticipated increase in carbon taxes and the significant costs which the company will have to incur if it is to meet its commitments.

In the financial statements for the year ended 31 December 20X7, Juan Co has carried out impairment tests and has not recognised an impairment loss.

REQUIREMENTS (25 MARKS)

(a) Many preparers of financial statements feel that there is sufficient disclosure of climate-related matters in the management commentary and therefore there is no need to disclose any further information in the actual financial statements, especially if there is no impact on those financial statements. Even though there is an acceptance that investors feel such information is important, some preparers think that the materiality decision does not extend to climate change as there is no IFRS standard dealing with the subject.

Discuss the validity of the above views expressed by preparers of financial statements regarding materiality.

Note: you do not need to refer to any exhibit when answering part (a).

(5 marks)

(b) Discuss the potential effects of climate-related matters on the financial statements of Juan Co for the year ended 31 December 20X7 in applying the following IFRS standards.

(i) IAS 16 *Property, Plant and Equipment* and IAS 38 *Intangible Assets*

(6 marks)

(ii) IAS 36 *Impairment of Assets*

(6 marks)

(iii) IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*

(6 marks)

Professional marks will be awarded for the overall understanding of climate-related issues in corporate reporting.

(2 marks)