May 2010 paper - Section A 20 marks

Section A – 20 marks

1.1 Answer is C

Raising as much money as possible for the government is not generally regarded as a principle of an ideal tax system.

The main principles of an ideal tax system are:

- **Equality -** tax payments should be proportional to income that being fair and equitable.
- **Certainty** - tax liabilities should be clear and certain.
- **Convenience of payment** - taxes should be collected at a time and in a manner convenient for taxpayer.
- **Economy of collection** ó taxes should not be expensive to collect and should not discourage business.

The three major principles in a modern tax system are:

- **Efficiency** ó it must be easy and cheap to collect, an example of this is the Pay As You Earn (PAYE) tax system for employees in the UK. In this system any tax owed by employees on earnings is deducted at source (by the employer) before they are given their net salary.
- **Equity** ó it must be fair and equitable to all taxpayers.
- **Economic effects must be considered** ó the way in which is collected must not have a detrimental effect on the taxpayer.

1.2 Answer is D

Answer D is correct because it is an example of a progressive tax system. This a tax system which increases its rate of tax as the income of the taxable person increases. In the UK the income tax system is progressive as it has higher rates of tax when individuals earn more.

Answer A is not correct because it is an example of a proportional tax system. This is a tax system where the rate of tax is the same regardless of the amount it is applied to. An example of such a system is VAT in the UK.

Answer B is incorrect as it takes it to account goods or services provided and not the income of taxable persons.

Answer C is incorrect as it takes into account wealth of taxable persons and not income.

1.3 Answer is B $3,461

Carrying value of equipment as at 31st March 2010			
$	**CV at start of year (1)**	**20% depreciation (2)**	**CV at end of year (1 – 2)**
1st year ó 31/03/08	60,000	12,000	48,000
2nd year ó 31/03/09	48,000	9,600	38,400
3rd year ó 31/03/10	38,400	7,680	30,720
Capital allowances – 50% in first year, thereafter 25% reducing balance (as per instructions in front of the exam paper)			
$	**TWDV at start of year (1)**	**Tax depreciation (2)**	**TWDV at end of year (1 – 2)**
1st year ó 31/03/08	60,000	(50%) 30,000	30,000
2nd year ó 31/03/09	30,000	(25%) 7,500	22,500
3rd year ó 31/03/10	22,500	(25%) 5,625	16,875

Deferred tax
CV = 30,720
TWDV = 16,875
Difference = (30,720 ó 16,875) = 13,845
Deferred tax = 13,845 x 0.25 = $3,461

1.4 Answer is A

The format of financial statements is covered by IAS 1

1.5 Answer is A

Timely and reliability conflict, if information is reliable it may not be on time, hence there is a conflict.

1.6 Answer is B $1,200 profit

IAS 18 Revenue recognition applies here.

6months revenue = $500 x 6 = $3,000
Less 6 months costs = $300 x 6 = $1,800
Profit ($3,000 - $1,800) = $1,200

The remaining money received will be deferred income in the statement of financial position.

1.7 Answer is D

Under IAS 38, development expenditure can only be capitalised (deferred) if strict criteria are met:

- Separately and clearly defined project
- Expenditure is separately identifiable
- Commercially viable, and overall profit is expected
- Technically feasible, and resources exist to complete the project

Statement A ó this canøt be deferred as the propulsion system is not viable.
Statement B ó research costs are always written off to the income statement.
Statement C ó this canøt be deferred as the project is expected to make an overall loss
Statement D ó this meets all the criteria

1.8 Answer is B

Total lease payments ($24,000 x 6 years)	$144,000
Fair value	$106,000
Total finance charge	$ 38,000

$38,000 finance charge will be allocated using the sum of digits method.

Year	Digit	Fraction (1)	Total finance charge £ (2)	Finance allocation for the year £ (1) x (2)
1	6	6/21	38,000	10,857
2	5	5/21	38,000	9,048
3	4	4/21	38,000	7,238
4	3	3/21	38,000	5,429
5	2	2/21	38,000	3,619
6	1	1/21	38,000	1,809
	21			**38,000**

Year	Open. liability (1)	Finance allocation (2)	Rental payments (3)	Capital repayment 3-2	Closing liability 1+2-3
1	106,000	10,857	24,000	13,143	92,857
2	92,857	9,048	24,000	14,952	77,905
3	77,905	7,238	24,000	16,762	61,143

The current liability for year 2 is actually 16,762. The question wording is misleading; it should say the total outstanding liability for year 2 on the lease which is $77,905 (B).

1.9 Answer is C

Only direct costs and losses of discontinued operations can be included. Cost of re-structuring head office is not related to the discontinued operations.

1.10 Answer is A $98,000

Current tax (CT) payable and defer tax (DT)

		Bal b/f - CT	106
		Bal b/f ó DT	27
Cash paid (bal fig)	***98***	Income statement charge for the year	122
Bal c/f ó CT	119		
Bal c/f ó DT	38		-
Total	**255**	**Total**	**255**

Section B – 30 marks

Question 2 (a)

Required:
Explain the difference between tax evasion and tax avoidance, using Cee and Gee to illustrate your answer.

(Total for sub-question (a) = 5 marks)

Tax evasion is the minimising or the not paying of any tax at all to the authorities by deliberately breaking the tax rules which is an illegal activity, for example the non-declaration of cash sales to the tax authorities. Gee is illegally evading tax by failing to declare his income from his night security guard job.

Tax avoidance is the arranging of tax affairs to deliberately take full advantage of tax reliefø and incentives or it maybe the exploitation of any loopholes in the tax rules. It is a legal activity and not breaking the law as it aims to minimise the tax liability whilst complying fully with all tax rules. Tax advisors will provide expert help in constructing legal schemes in avoiding tax.

Any weaknesses in the current tax rules will normally be closed up with legislation passed by the government but it takes time to do this and the loophole is open for exploitation until this legislation comes into effect. It is very rare for governments to retrospectively legislate against loopholes. Cee has reduced her tax bill legally by arranging her tax affairs within the tax legislation. She has taken advice to invest in government securities which generate tax free income.

Question 2 (b)

Required:
(i) Explain the difference between unit taxes and ad valorem taxes, using the scenario above to illustrate your answer. ***(3 marks)***

(ii) Calculate the amounts of indirect tax payable by W for the year ended 31 December 2009. ***(2 marks)***

(Total for sub-question (b) = 5 marks)

(i)

Unit tax ó is based on physical measure being perhaps the number of units sold or produced. Examples of a unit tax are excise duties; quantity of petrol sold and amount of oil extracted. Unit taxes are useful in that they can specifically target certain commodities and thereby allowing precision without impacting on other commodities. In the scenario when the wine is bottled W pays $1 tax per bottle to the tax authorities, this is an example of a unit tax.

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Ad valorem tax ó is based on the value of sales. The most common example of this is a sales tax or value added tax (VAT). In the scenario W sells a bottle of wine for £8.05 on average which includes VAT at standard rate. This means a selling price of $7 plus VAT of $1.05 per bottle.

(ii)

	Net $	VAT $
Sales ($7 x 10,000)	70,000	
Output VAT ($1.05 x 10,000)		10,500
Ingredients and other running costs	(30,000)	
Input VAT (30,000 x 15%)		(4,500)
Excise duty ($1 x 10,000)	(10,000)	
Profit	30,000	
VAT payable		6,000
Excise duty		10,000
Total indirect tax by W		16,000

Question 2 (c)

Required:
Explain the terms õcompetent jurisdictionö and õwithholding taxö. Illustrate how each relates to the H group.

(Total for sub-question (c) = 5 marks)

Competent jurisdiction ó This is the authority responsible for collecting and administering the taxes in a tax jurisdiction. A tax jurisdiction is an area in which tax rules apply, normally a country. For example the UK is a tax jurisdiction and its competent jurisdiction for direct and indirect taxes is known as Her Majestyøs Revenue and Customs (HMRC).

In the scenario H holds regular senior management meetings in County X according to OECD model tax convention this makes H resident in Country X for tax purposes. This can also be applied to S where their senior management meet in Country Y and so therefore resident in Country Y for tax purposes.

Withholding tax - If a company remits income abroad to another country then there maybe some tax that has to be paid before it leaves the country. This is known as withholding tax (WHT) and is designed to stop companies not paying any tax in the country of residence by sending all income abroad and then ceasing trade.

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Examples of types of payments affected by this are dividends, interest payments, royalties and capital gains accruing to non-residents. However the foreign income received by the non-resident company would have to be subject to tax both in the non-resident and resident country. Double taxation relief (DTR) is used to mitigate taxing overseas income twice. There is normally a bilateral agreement between countries to address this.

In the scenario H is to receive a dividend from S but it must be first subject to a deduction of tax at source by S of 10%. If there is a double taxation treaty between Country X and Country Y using the OECD model tax convention, then H will be allowed to claim double taxation relief of $20,000, being 10% of itøs dividend received from S of $200,000. This will take the form of a tax credit used against any tax due for H in Country X.

Question 2 (d)

Required:

(i) Explain the objective of an external audit. (2 marks)

(ii) Assuming that ABøs directors continue to refuse to amend the financial statements, explain the type of audit report that would be appropriate for the auditors to issue.

(3 marks)

(Total for sub-question (d) = 5 marks)

(i) An **audit** is an **independent examination** of the financial statements by **experts** (known as auditors) to **express an opinion** on whether they are **true and fair**. It is another legal requirement for incorporated entities.

True and fair

True - information is factual and conforms to reality, not false and correctly extracted from books and records.

Fair - information is free from discrimination and bias and is in compliance with required standards and law. Reflects underlying transactions.

It is important to remember that auditors can only express an opinion. They cannot ÷certifyø whether financial statements are completely correct. The audit opinion does not look at managerial efficiency and effectiveness, or at staff honesty.

(ii) Audit report

The auditors can give:

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Unqualified report - states that they are in agreement with the financial statements.
Qualified report - states that they do not agree with the financial statements due to disagreements or uncertainties.

The amount of write down is $1million which is 25% of the total profit. This is therefore material. The auditors will give a qualified report stating that the accounts give a true and fair view except for the material overstatement of closing inventory and profits by $1 million.

The disagreement is material and not fundamental, hence itøs and õexcept forö qualified report and not an adverse opinion.

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Question 2 (e)

Required:
Calculate the amounts to be recorded for the above contract in CCøs statement of comprehensive income for the year ended 31 March 2010 and in the statement of financial position at that date.

Show all calculated figures to the nearest $ million.

(Total for sub-question (e) = 5 marks)

Step 1 – Compare contract value and total expected costs

$m	Year ending 31/03/09	Year ending 31/03/10
Total contract value	63	63
Costs incurred to date	(18)	(18 + 26)(44)
Estimated costs to complete	(36)	(20)
Profit / (loss)	9	(1)

The entire loss of $1 million will be recognised immediately. However as CC recognised a $4 million profit for year ending 2009, this also needs to be reversed, so the entire loss for year ending 2010 will be $5 million.

Step 2 Establish revenue and costs for income statement extracts

Income statement	Year ending 2010
$m	
Revenue (40% x 63)	25
Costs of sales (bal fig)	(30)
(Loss)	(5)

Step 3 Calculate the construction contract balances in the statement of financial position.

Statement of financial position balances	$m
Costs incurred to date (18 + 26)	44
Less transfers to costs of sales for 2010 (step 2)	(30)
Less transfers to cost of sale for 2009	(18)
Work in progress (current assets)	
Accruals for foreseeable losses (current liability)	(4)
Receivables	
Revenue less progress payments (25 + 22 ó 15 - 22)	10

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IAS 11 does allow accruals for foreseeable losses to be offset against gross amounts due from customers under current assets.

Statement of financial position as at 31/03/10 (extracts)

Current assets	$m
Amounts due from customer (10 ó 4)	6

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Question 2 (f)

Required:
Assume that you are a trainee accountant with AD.

ADøs finance director has asked you to draft a briefing note that she can use to prepare a response to ADøs management.

Your briefing note should explain how AD should treat the shoe factory in its financial statements for the year ended 31 March 2010.

You should make reference to any relevant International Financial Reporting Standards and to CIMAøs Code of Ethics for Professional Accountants.

(Total for sub-question (f) = 5 marks)

Tutor note: Always identify the relevant accounting standard/s and principles, describe them and then relate to the scenario to maximise your marks.

Briefing note

IFRS 5 Non-current assets for sale and discontinued operations

A discontinued operation is either disposed of or held for sale by the organisation:

- Itøs a major separate line of business or in a different geographical area
- Will be disposed in a single go
- Is a subsidiary held for sale

An operation is classified as discontinued at the date the organisation has actually disposed of the operation, or when the operation meets the criteria to be classified as held for sale (same as above).

- The management is **committed** to a plan to sell.
- The asset is available for **immediate** sale.
- An active programme to locate a **buyer** is initiated.
- The sale is highly probable, **within 12 months** of classification as held for sale.
- The asset is being actively **marketed** for sale at a fair price.
- The actions required to complete the plan should indicate that it is unlikely that significant changes to the plan will be made or that the plan will be withdrawn.

Presentation in the financial statements of discontinued operations

Income statement

One single amount on the face of the income statement, under discontinued operations

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Post tax profit for the period from discontinued operations

In the notes to the accounts, the post tax profit is analysed into:

Revenue
Expenses
Pre-tax profit or loss
Tax

} All related to the discontinued operations

Alternatively, the above can be shown on the face of the income statement as a column under discontinued operations.

Detailed disclosure is required either in the notes or on the face of the income statement in a section distinct from continuing operations. Such detailed disclosures must cover both the current and all prior periods presented in the financial statements.

The statement of financial position

Assets and disposal groups classified as held for sale must be presented separately on the face of the statement of financial position.

The assets or group of assets for disposal should be measured at the l**ower of carrying value and fair value less costs to sell** (i.e. its net realisable value NRV)

Impairment must be considered both at the time of classification as held for sale and subsequently.

For AD the criteria for the factory to be classified as discontinued operations has not been met at the year end. On 31st March, the management has not attempted to find a buyer for the factory or its assets. AD is still negotiating payment terms for the workforce and has not agreed a closure date.

Hence under IFRS 5, the factory canøt be treated as discontinued operations and will be shown as part of the continuing operations for year ending 31st March 2010.

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CIMA's Code of Ethics for Professional Accountants

Qualified professional accountants must act ethically to ensure that they are not acting illegally; ensure that reporting and professional standards are being met, the professionøs reputation is protected and that they serve the public interest.

CIMA have set out fundamental principles that members must abide by. These are:

- Integrity.
- Objectivity.
- Confidentiality.
- Professional behaviour.
- Professional competence and due care.
- Professional and technical standards.

If the shoe factory is excluded from continuing operations, then compliance with relevant accounting standards are not met. This would make the financial statements not true and fair. The objectivity of the individual is questioned as is professional behaviour. Accountants must ensure that they are honest with all their dealings and can carry themselves with integrity.

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Section C – 50 marks

Question 3

Required:

Prepare EZøs statement of comprehensive income and statement of changes in equity for the year to 31 March 2010 and a statement of financial position at that date, in a form suitable for presentation to the shareholders and in accordance with the requirements of International Financial Reporting Standards.

Notes to the financial statements are not required, but all workings must be clearly shown. Do **not** prepare a statement of accounting policies.

(Total for Question Three = 25 marks)

Revision - Exam technique for preparing financial statements

Step 1	**Layout pro-forma's** For the statement of comprehensive income (income statement) and statement of financial position (balance sheet), allow for 2 whole A4 sides for each statement. For the statement of changes in equity allow 1 whole A4 side. For the statement of cash flows all 2 whole A4 sides. You can layout the pro-formaøs now or do them after you have done all the workings. The workings should start after the pro-forma. This method will ensure that all the workings are in one area of the answer book and it will be easy to add more workings as and when necessary. This will make it easier for the marker of the exam script to follow.
Step 2	**Work through the notes** On the workings page, start off by working through the additional information provided, systematically, note by note. In your answer script detail exactly what needs to be done. **It is imperative that you show all your workings!** This will involve: (i) **Identify** any relevant accounting standards / accounting principles, describing the accounting standards and explaining the treatment of the transaction. (ii) Write out the **journal entries** (iii) Show all **calculations** (iv) Detail the **destination** of transactions (i.e. income statement/balance sheet/ statement of changes in equity)

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Step 3	**Additional calculations** After the notes have been dealt with, do the following calculations before completing the financial statements: **(i) Depreciation** **(ii) Cost of sales** **(iii) Carrying value of tangible and intangible assets** **(iv) Taxation charge**
Step 4	**Complete the financial statements** Pick the figures from the trial balance and insert into the pro-forma financial statements (ensuring you tick and bash the trial balance and also incorporate the workings done during step 2 and step 3). Ensure the workings are cross referenced. Order of completion: 1 Statement of comprehensive income (income statement) 2 Statement of changes in equity 3 Statement of financial position (balance sheet)

Step 1 Lay out pro-formas (see later)

Step 2 Work through the notes

(i) Land

EZ currently employs the revaluation model. The revaluation reserve is currently $10,000. The revaluation at the year end is a subsequent revaluation.

Revision - Previously revalued assets

1 If an asset was previously revalued downwards, which resulted in the revaluation deficit being taken to the income statement as a loss (included in the profit or loss for the year), then subsequent upward revaluation can recognised in the income statement BUT only to the extent that it reverses the previous loss. This means the subsequent revaluation surplus forms part of the profit for the year, to offset the loss in the previous revaluation. Any remaining revaluation surplus (after the loss has been covered) is shown as part of other comprehensive income and goes to the revaluation reserve.

Debit	Non current asset (statement of financial position)
Credit	Revaluation gain (income statement)

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2 If an asset was previously revalued upwards, which resulted in the revaluation surplus being taken to the revaluation surplus under other comprehensive income, then a subsequent downward revaluation loss can be taken as a debit to the revaluation surplus under other comprehensive income, BUT only to the extent it reverses the previous gain. Any remaining revaluation deficit (after the surplus has been covered) is taken to the income statement and forms part of the profit or loss for the year.

Debit	Revaluation surplus (other comprehensive income)
Credit	Non current asset (statement of financial position)

The accumulated depreciation is reset to zero and the new depreciation is calculated on the revalued amount. The useful economic life may also need reviewing.

So essentially on subsequent revaluations, the original opposite deficit or surplus are offset in the same area of the financial statements. Any remaining subsequent revaluations are then treated as normal.

If subsequent revaluations result in same deficit or surplus as the original revaluation, the treatment is obviously as per the original revaluation.

	$ø000
Land value as per trial balance	700
Revaluation at 31st March 2010	675
Revaluation loss	(25)

The previous revaluation gain will be reversed and the remaining will go to the comprehensive income statement profit for the year part

		$ø000	$ø000
Credit	Land (statement of financial position)		25
Debit	Revaluation reserve (statement of changes in equity)	10	
Debit	Revaluation loss (income statement)	15	

As the loss is material, it will be shown as a separate line on the face of the income statement.

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(ii) Tax

	$ø000	
Tax estimate for the year	18	Dr tax expense (IS), Cr tax liability (BS)
Under / over provision from previous year	-	
Less decrease in deferred tax	(10)	Cr tax expense (IS), Dr deferred tax (BS)
Income statement charge for the year	**8**	

Deferred tax will reduce to $20,000 for 31/03/10

(iii) Disposal of asset

Gain or loss on disposal	=	Sales proceeds - Carrying value
	=	$2,000 - $7,000
Loss	=	$5,000

The loss will be taken to the cost of sales. The suspense account will be cleared.

		$ø000	$ø000
Credit	Plant, property and equipment cost		37
Debit	Plant, property and equipment depreciation (37 ó 7)	30	
Debit	Suspense account	2	
Debit	Cost of sales	5	

(iv) Depreciation

Depreciation on plant, property and equipment (PPE)

	$ø000
PPE cost at 31/03/09 (as per trial balance)	480
Less disposal	(37)
	443
Depreciation for the year at 10% straight line (443 x 10%)	**44**
Accumulated depreciation b/f (less disposal ó 144 ó 30)	114
Carrying value of PPE at 31/03/10 (443 – 44 – 114)	**285**

(v) Dividend

This has already been paid and will be shown in the statement of changes in equity.

(vi) Issue of shares

The issue of shares will be shown under the statement of changes in equity.
Nominal value of shares issued $200,000
Share premium at 50% $100,000

The opening balances for the share premium and nominal account will need to be reduced from the trial balance figures as they include the issue during the period.

(vii) Loan interest

Accrue for loan interest for the full year.

$250,000 x 4% = $10,000

		$ø000	$ø000
Credit	Interest payable (statement of financial position)		10
Debit	Finance cost (income statement)	10	

(viii) Bad debt

Trade receivables will be reduced by $125,000 as the customer has gone into liquidation and therefore under prudence the loss has to be accounted for now. The loss will be shown as part of administration expenses.

		$ø000	$ø000
Credit	Trade receivables		125
Debit	Bad debt (administration expenses)	125	

Trade receivables at year end = (275,000 ó 125,000) = $150,000

(ix) Operating lease rentals on vehicles

Total lease rentals will spread systematically over the 2.5 years period.

30 months lease rental period with 6 months free rental = 24 months
Total lease rentals = 24 months x $2,500 = $60,000

Therefore monthly charge to the income statement = $60,000 / 30 months = $2,000

For year ending 31/03/10 = 12 months
- Charge for the year = 12 months x $2,000 = $24,000.
- $15,000 has already been paid as per trial balance.
- Therefore need accrual of (24,000 ó 15,000) = $9,000

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		$ø000	$ø000
Credit	Lease rentals payable (statement of financial position)		9
Debit	Distribution (income statement)	9	

Step 3 Additional calculations

1 Cost of goods sold

(Tutor note: The cost of sales has already been done in the trial balance with the closing inventory at year end)

	$ø000
As per trial balance	418
Loss on disposal of PPE	5
Depreciation of PPE	44
	467

2 Administration

	$ø000
As per trial balance	86
Bad debt	125
	211

3 Distribution costs

	$ø000
As per trial balance	69
Bad debt	24
	93

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EZ: Statement of comprehensive income for year ended 31st March 2010	
	$ø000
Revenue	720
Cost of sales (W1)	(467)
Gross profit	253
Distribution costs (W3)	(93)
Administrative expenses (W2)	(211)
Loss on revaluation of land (note i)	(15)
Finance costs (note vii)	(10)
Loss before tax	(76)
Income tax expense (note ii)	(8)
Loss for the year	(84)
Other comprehensive income	
Reversal of revaluation gain for land	(10)
Total comprehensive income for the year	(94)

EZ: Statement of changes in equity for year ending 31st March 2010

$ø000	Equity share capital	Share premium	Revaluation Reserve	Retained earnings	Total
Balances b/f	*400	*200	10	181	791
New issues of shares	200	100			300
Total comprehensive income for the year			(10)	(84)	(94)
Dividends				(92)	(92
Balances c/f	**600**	**300**	**0**	**5**	**905**

**Balances from the trial balance reduced by the change during the year.*

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EZ: Statement of financial position at 31st March 2010		
	$ø000	$ø000
Assets		
Non-current assets		
Property, plant and equipment (note iv)		285
Land (note i)		675
		960
Current assets		
Inventories	112	
Trade receivables (note viii)	150	
Cash and cash equivalents	22	
		284
		-
Total assets		**1,244**
Equity and liabilities		
Share capital $1 ordinary shares	600	
Share premium account	300	
Revaluation reserve	0	
Retained earnings	5	
Total equity		905
Non- current liabilities		
Long term borrowings	250	
Deferred tax (note ii)	20	
		270
Current liabilities		
Trade payable	32	
Lease rentals accrual (note ix)	9	
Interest payable (note vii)	10	
Income tax payable (note ii)	18	
Total current liabilities		69
		-
Total equity and liabilities		**1,244**

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Question 4

Required:

(a) Calculate the estimated amount of corporate income tax that AX will be due to pay for the year ended 31 March 2010 and any required adjustment to the provision for deferred tax at that date.

(5 marks)

(b) Prepare a Consolidated Statement of Comprehensive Income for the AX Group of entities for the year ended 31 March 2010 and a Consolidated Statement of Financial Position as at that date.

Notes to the financial statements are not required but all workings must be shown.

(20 marks)
(Total for Question Four = 25 marks)

(a) Tax

	$ø000
AX accounting profit for the year	264
Add back disallowable expenditure	
Depreciation	31
Entertaining expenses	4
Less capital allowances	(49)
AX taxable profit for the year	250
Tax at 25%	**63**
Defer tax	
Increase in temporary differences (49 ó 31)	18
Tax at 25%	**5**

As more capital allowances than depreciation defer tax increases by 5

		$ø000	$ø000
Credit	Tax payable for AX ó SOFP		63
Debit	Tax expense for AX ó IS	63	
Debit	Tax expense for AX ó IS	5	
Credit	Deferred tax for AX ó SOFP		5

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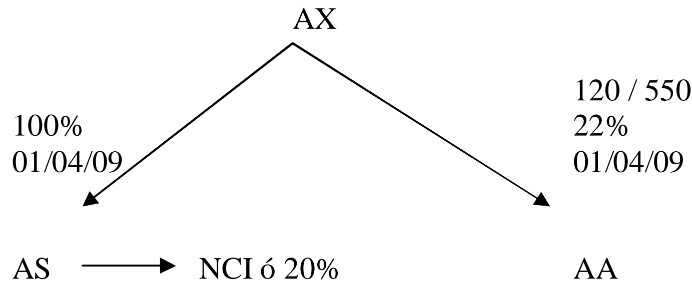
(b) Consolidated financial statements

Step 1 – Group structure based on equity shares



Relationship and accounting treatment

AX has all of the voting rights of AS, therefore can control AS. AS is a subsidiary of AX and will be consolidated 100% line by line under IAS 27.

AX has a significant amount of equity shares in AA, therefore AA is an associate of AX and will be consolidated using the equity method of accounting under IAS 28

Step 2 – Layout pro-forma (consolidated statement of financial position & consolidated statement of comprehensive income)

Leave 3 whole A4 sides blank in the exam. This will ensure that all the workings follow through on the next 4th page. This makes it easier for the marker to follow the workings.

Step 3 – Consider adjustments

Go through the additional information given in the exam and work through systematically note by note, detailing exactly what needs to be done.

Paragraph 1 – AS investment details

The fair value of $75,000 will be dealt with under goodwill (step 4). As the land still exists at the year end, $75,000 will be added to property plant and equipment upon consolidation (assume AS has not recorded the affects of the valuation in their individual financial statements).

AX investment details will be dealt with under goodwill.

Additional information note (i) tax has already been dealt with under part a.

Additional information note (ii) Inter Company trading

AS sells goods to AX (subsidiary to parent)

Total sales value - $55,000 ó reduce consolidated revenue and consolidated cost of sales

Unsold year end inventory which is intercompany, calculate the provision for unrealised profit (PUP).

$25,000 x 25/125 = $5,000

Debit Consolidated COS $5,000
Credit Consolidated inventory $5,000

Step 4 – Goodwill calculation

	AX in AS		AX in AA	
	$ø000	$ø000	$ø000	$ø000
		740		
Cost of investment at fair value				145
Less share of net identifiable assets acquired at fair value at date of acquisition				
Share capital	600		550	
Reserves	(72)		49	
Fair value adjustments	75		-	
Other adjustments	-		-	
	603		599	
Group share (100%, 22%)		(603)		(132)
Goodwill at date of acquisition		137		13
Impairment		-		-
Goodwill at year end		**137**		**13**

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Investment in associate undertaking (one liner for the consolidated statement of financial position)

Investment in associate undertaking	$ø000
Cost of investment	145
Add group share of post acquisition retained reserves ó 22% (100 ó 49)	11
Less goodwill impairment	-
Investment in associate undertaking	**156**
Or alternatively	
Group share of net assets at year end date (22% x 650)	143
Plus goodwill	13
Less goodwill impairment	-
Investment in associate undertaking	**156**

Step 5 Combine the financial statements

Consolidated statement of comprehensive income for AX group for year ending 31st March 2010	
	$ø000
Turnover (820 + 285 ó 55)	1,050
Cost of sales (406 + 119 ó 55 + 5)	(475)
Gross profit	575
Admin expenses (84 + 36))	(120)
Distribution costs (48 + 22)	(70)
Finance costs (18 + 5)	(23)
Profit before tax ó group	362
Share of associates profit before tax (62 x 22%)	14
	376
Taxation - group (16 + 63 + 5)	(84)
Taxation ó share of associate (11 x 22%)	(2)
Profit for the year	290

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AX Group: Consolidated statement of financial position as at 31st March 2010

	$ø000	$ø000
Non current assets		
Goodwill (W4)		137
Plant, property and equipment (1120 + 700 + 75)		1895
Investment in associate undertaking (W4)		156
		2,188
Current assets		
Inventories (205 + 30 ó 5)	230	
Trade receivables (350 + 46)	396	
Cash and cash equivalents (30)	30	
		656
Total assets		**2,844**
Capital and reserves		
Ordinary shares ($1) (parent only)	1,500	
Consolidated reserves (bal figure) (W7)	543	2,043
Non controlling interest (n/a)		-
		2,043
Non current liabilities		
Borrowings (360 + 80)	440	
Deferred tax (120 + 16 + 5)	141	
		581
Current liabilities		
Trade payables (92 + 29)	121	
Tax (16 + 63)	79	
Bank overdraft (20)	20	220
Total equity and liabilities		**2,844**

Step 6 Non controlling interest

Not applicable here as subsidiary is 100% owned.

Step 7 Prove consolidated reserves

$'000	AX	AS	AA
Reserves as per question	518	15	100
Adjustment for tax (63 + 5)	(68)		
Adjustment ó PUP on year end inventory	-	(5)	-
Adjusted reserves	450	10	100
Group share of post acquisition retained reserves (PARR)			
AS ó (10 + 72) x 100% - remember debit balance for reserves at DOA	82		
AA ó (100 ó 49) x 22%	11		
Less goodwill impairment	-		
Consolidated reserves	**543**		

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