
Answers

1 (a) Consolidated Balance Sheet of Hoedown as at 30 September 2003:

| | \$000 | \$000 |
|---|-------|---------------|
| Non-current assets | | |
| Property, plant and equipment $(8,400 + 2,630 + (2,000 + 500 - 100)/2)$ | | 12,230 |
| Goodwill $((800 - 320) (w (i)) + (500 - 50) (w (v)))$ | | 930 |
| Investments $(4,000 - 3,000 + 350 + 150 + 40)$ | | 1,540 |
| | | <u>14,700</u> |
| Current assets | | |
| Inventory $(750 + 580 + (760/2) - 10 \text{ URP})$ | 1,700 | |
| Accounts receivable $(370 + 440 + (300/2))$ | 960 | |
| Bank $(120 + (240/2))$ | 240 | |
| | | <u>2,900</u> |
| Total assets | | <u>17,600</u> |
| Equity and liabilities | | |
| Capital and reserves: | | |
| Ordinary shares of \$1 each $(2,000 + 400 (w (v)))$ | | 2,400 |
| Reserves | | |
| Share premium $(1,200 + 1,600 (w (v)))$ | 2,800 | |
| Accumulated profits $(w (ii))$ | 9,432 | |
| | | <u>12,232</u> |
| | | 14,632 |
| Minority interest $(w (iii))$ | | 578 |
| Non-current liabilities | | |
| Deferred tax $(400 + (200 - (400 \times 25\%)) + (100/2))$ | | 550 |
| Current liabilities | | |
| Accounts payable $(260 + 940 + (220/2))$ | 1,310 | |
| Taxation $(180 + 190 + (180/2))$ | 460 | |
| Overdraft | 70 | |
| | | <u>1,840</u> |
| Total equity and liabilities | | <u>17,600</u> |

Workings (Note: all figures in \$000)

There are several methods of preparing consolidated working schedules. No one method is considered superior to another. All correct workings will gain appropriate marks.

Proportional consolidation requires the group share (50%) of the Jennivere's line items to be added to the group's own figures for the line items.

| | | |
|---|--------------------|----------------|
| (i) Cost of control investment at cost $(1,500 \times 80\% \times \$2.50)$ | | 3,000 |
| less ordinary shares | 1,500 | |
| share premium | 500 | |
| pre-acq profits | 600 | |
| increase in profit – group policy for investment property | 150 | |
| | <u>2,750</u> x 80% | <u>(2,200)</u> |
| consolidated goodwill | | <u>800</u> |
| Goodwill of \$800 is depreciated over five years for two years = \$320 | | |
| (ii) Accumulated profits | | |
| Hoedown per question $(8,100 + 1,500)$ | | 9,600 |
| unrealised profit in inventory $(w (iv))$ | | (10) |
| goodwill amortisation $(320 (w (i)) + 50 (w (v)))$ | | (370) |
| post acquisition reserves of Sundown: | | |
| per question $(900 - 300)$ | 600 | |
| surplus on investment property taken to income | 40 | |
| reduction in deferred tax | 100 | |
| reserves at acquisition | (600) | |
| | <u>140</u> x 80% | 112 |
| share of joint venture profit $((600 \times 6/12) - 100 \text{ additional depreciation}) \times 50\%$ | | <u>100</u> |
| accumulated consolidated reserves | | <u>9,432</u> |

| | | | |
|--|--------------|-------|----------------|
| (iii) Minority interest | | | |
| ordinary shares | 1,500 | | |
| share premium | 500 | | |
| accumulated profits | | | |
| per question | 600 | | |
| reduction in deferred tax | 100 | | |
| increase in profit – group policy for investment property | 150 | | |
| further surplus on investment property | 40 | | |
| | <u>2,890</u> | x 20% | <u>578</u> |
| (iv) URP in inventory | | | |
| Sales of \$200,000 at a mark up on cost of 25% would give a profit of \$40,000 (200,000 x 25/125). Half of these goods have been sold so the unrealised profit is \$20,000; however, as the sale is to a joint venture, only the group share of the unrealised profit is eliminated i.e. \$10,000. | | | |
| (v) Joint venture – calculation of goodwill | | | |
| investment at cost (500 x 4/5 x \$5) | | | 2,000 |
| net assets on acquisition (equal to shareholders' funds) at 30 September 2003 | 2,800 | | |
| less post acquisition profit (600 x 6/12) | (300) | | |
| fair value adjustment | 500 | | |
| | <u>3,000</u> | x 50% | <u>(1,500)</u> |
| Goodwill | | | <u>500</u> |

This is depreciated for six months of a five-year life = \$50

The investment in Jennivere is paid for by an issue of 400,000 (4 for 5) at \$5 each. This is \$2 million and would be recorded as \$400,000 ordinary shares and \$1.6 million share premium.

2 (a) (i) Lavalamp Income Statement – Year to 30 September 2003

| | |
|--|---------------|
| | \$000 |
| Sales revenue | 112,500 |
| Cost of sales (w (i)) | (83,610) |
| Gross profit | 28,890 |
| Operating expenses (11,400 + 2,000 – 600 operating leases) | (12,800) |
| Operating profit | 16,090 |
| Finance costs (2,000 + 220 (w (iii)) and (iv)) | (2,220) |
| Profit before tax | 13,870 |
| Taxation | (3,470) |
| Net profit for the period | <u>10,400</u> |

(ii) Lavalamp – Statement of Changes in Equity – Year to 30 September 2003

| | Share capital \$000 | Share premium \$000 | Revaluation reserve \$000 | Accumulated profits \$000 | Total \$000 |
|---|---------------------------|---------------------------|---------------------------------|---------------------------------|----------------|
| Balance at 1 October 2002 | 16,000 | 7,600 | nil | 3,600 | 27,200 |
| Rights issue (1 for 4 at \$1.60) | 4,000 | 2,400 | | | 6,400 |
| Surplus on revaluation of property (w (ii)) | | | 5,250 | | 5,250 |
| Net profit for the period | | | | 10,400 | 10,400 |
| Dividends paid | | | | (1,200) | (1,200) |
| Transfer to realised profits (5,250/15 years) | | | (350) | 350 | nil |
| Balance at 30 September 2003 | <u>20,000</u> | <u>10,000</u> | <u>4,900</u> | <u>13,150</u> | <u>48,050</u> |

(iii) Lavalamp – Balance Sheet as at 30 September 2003

| | \$000 | \$000 |
|---|--------|---------------|
| Non-current assets | | |
| Intangible development costs (5,000 – 500 (w (ii))) | | 4,500 |
| Property, plant and equipment (w (ii)) | | 42,340 |
| | | <u>46,840</u> |
| Current Assets | | |
| Inventory | 21,800 | |
| Accounts receivable | 25,550 | 47,350 |
| | | <u>94,190</u> |
| Total assets | | |
| Equity and liabilities: | | |
| Ordinary shares of \$1 each | | 20,000 |
| Reserves (from (b) above): | | |
| Share premium | 10,000 | |
| Accumulated profits | 13,150 | |
| Revaluation reserve | 4,900 | 28,050 |
| | | <u>48,050</u> |
| Non-current liabilities | | |
| 8% loan note | 25,000 | |
| Lease obligations (w (iii)) | 3,621 | 28,621 |
| | | <u>28,621</u> |
| Current liabilities | | |
| Accounts payable | 7,300 | |
| Overdraft | 4,000 | |
| Taxation | 3,470 | |
| Accrued interest (w (iv)) | 1,220 | |
| Provision for damage to property (w (i)) | 750 | |
| Lease obligation (w (iii)) | 779 | 17,519 |
| | | <u>17,519</u> |
| Total equity and liabilities | | <u>94,190</u> |

Notes:

There is a contingent liability of \$750,000 in respect of a claim from the landlord for alleged damage caused to a leased property.

Workings (all workings in \$000)

| | |
|--|---------------|
| (i) Cost of sales: | |
| Per question | 78,300 |
| Capitalised development costs | (5,000) |
| Provision for damage to property (see below) | 750 |
| Depreciation (w (ii)) | 9,560 |
| | <u>83,610</u> |

As there appears to be a dispute over the responsibility for the damage to the building, a reasonable approach would be to provide for half of the costs of the repair (it appears Lavalamp has accepted this much) and treat the remaining amount as a contingent liability. Alternatively, a more prudent view would be to provide for the whole amount.

- (ii) Tangible Non-current assets
Property, plant and equipment:

| | Cost/valuation | depreciation | carrying value |
|--|----------------|---------------|----------------|
| Non-leased plant | 34,800 | 19,360 | 15,440 |
| Leased plant | 5,000 | 500 | 4,500 |
| 20 year leasehold | 24,000 | 1,600 | 22,400 |
| | <u>63,800</u> | <u>21,460</u> | <u>42,340</u> |
| Depreciation for year (charged to cost of sales) | | | |
| Non-leased plant (34,800 x 20%) | 6,960 | | |
| Leased plant (5,000/ 5 years x 6/12) | 500 | | |
| 20 year leasehold (24,000/15 years (see below)) | 1,600 | | |
| Development costs (5,000/ 10 years (see below)) | 500 | | |
| | <u>9,560</u> | | |

The original annual depreciation would have been \$1,250 (25,000/20 years). The accumulated depreciation at 1 October 2002 of \$6,250 represents 5 years depreciation. Therefore after the revaluation there would be a remaining life of 15 years. The revaluation reserve would be \$5,250 (24,000 – (25,000 – 6,250)).

Advertising expenditure cannot be included as part of the cost of developing a brand. Nor can a market valuation be used unless there is an active market. There cannot be an active market for brands as they are by definition unique.

- (iii) Leased asset:

| | |
|---|--------------|
| fair value of plant | 5,000 |
| 1st rental (1 April 2003) | (600) |
| | <u>4,400</u> |
| capital outstanding at 30 September 2003 | 4,400 |
| accrued interest at 10% for six months to 30 September 2003 | 220 |
| | <u>4,620</u> |
| payment due (1 October 2003) | (600) |
| | <u>4,020</u> |
| accrued interest at 10% for six months | 201 |

The payments to be made in the year to 30 September 2004 of \$1,200 contains interest of \$421 (220 + 201), this means the capital element of next year's payments is \$779 which is a current liability. As the total capital outstanding at 30 September 2003 is \$4,400 then \$3,621 (4,400 – 779) is a non-current liability.

- (iv) Annual interest on the 8% loan would be \$2,000 only \$1,000 has been paid leaving a required accrual of \$1,000. The accrued interest on the lease for the six months to 30 September 2003 is \$220 (see (iii)).

- 3 (a) (i)** IAS 8 'Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies' advocates that in order for financial statements to be comparable over a period of time the consistent application of accounting policies is important. However there are circumstances where the principle of consistency should be departed from:
- a change may be required by statute,
 - a new accounting standard may render a previous accounting policy no longer appropriate/acceptable,
- or
- if the change will result in a more appropriate presentation of events and transactions leading to more relevant and reliable financial statements.

Changes in accounting policies commonly occur where subsidiaries are acquired that have different accounting policies from the rest of the group.

In some cases there may be an amount of confusion as to what constitutes a change of accounting policy. For example a change in the method of depreciation (e.g. reducing balance to straight-line) is not regarded as a change of policy, but a change from not depreciating an asset to depreciating it would normally be regarded a change in policy. Also adopting an accounting policy for the first time is not a change of policy nor is applying a different policy where transactions or circumstances differ substantially from previous transactions or circumstances.

| (ii) Income statement year to: | 30 September 2003 | 30 September 2002 (restated) |
|---|-------------------|---------------------------------|
| | \$000 | \$000 |
| Amortisation of development expenditure | 610 | 450 |
| Balance sheet | | |
| Intangible non-current assets | | |
| Development expenditure – cost (720 + 640 + 900 + 400) | 2,660 | (2,660 – 720 + 500) 2,240 |
| – amortisation (bal figure) | (910) | (800) |
| – net book value (see below) | <u>1,750</u> | <u>1,640</u> |
| Accumulated profit 1 October 2001 | 2,500 | |
| Prior period adjustment (see below) | 1,450 | |
| Accumulated profit 1 October 2001 as restated | <u>3,950</u> | |
| Workings (figures in brackets are \$ million): | | |
| Net book value 30 September 2003 (720 + (640 x 75%) + (900 x 50%) + (400 x 25%)) = | 1,750 | |
| Net book value 30 September 2002 (640 + (900 x 75%) + (400 x 50%) + (500 x 25%)) = | 1,640 | |
| Amortisation as at 30 September 2003 25% x (500 + 400 + 900 + 640) = | 610 | |
| Amortisation as at 30 September 2002 25% (500 + 400 + 900) = | 450 | |

Prior period adjustment

The amount of the prior period adjustment would be \$1,450 million being the net book value of the development expenditure that would have been included in the balance sheet at 30 September 2001 (effectively 1 October 2001). This would be a gross amount of \$1,800 million (500 + 400 + 900) less accumulated depreciation of \$350 million (500 x 50% + 400 x 25%).

- (b) (i) The requirement in IAS 35 'Discontinuing Operations' to provide an analysis between continuing and discontinuing operations is intended to achieve improvements to financial reporting in two ways. Firstly it complies with the concept of 'all inclusive' historical reporting. This means that the information is more reliable (because it can be verified – usually by an audit) and that all income is reported. In the past some company managers have sought to exclude gains and losses from discontinuing operations (or extraordinary items) on the basis that they will not recur in the future and thus reporting them may mislead users that are trying to predict future performance. The second benefit of information on discontinuing operations addresses this last point. As well as reporting/confirming past performance, there is no doubt that published financial statements are used in a predictive manner – it may be that the trend of recent past performance is a good indicator of future performance. If this is accepted, there can be no more important information when trying to assess future performance (by using past performance) than to know which parts of a business are continuing their operations and those which have ceased (by sale or closure) or are about to cease in the near future. In essence only the results of continuing operations should be used in forecasting future results; profits or losses from discontinuing operations will not be repeated. The timing of the closure of part of a business is not relevant to assessing future performance (only its results are), but the timing of any acquisition is as its included results will be only for part of the reporting period. In the subsequent year(s) results for a full year will be reported. Unfortunately IAS 35 is not prescriptive in this area.
- (ii) If no information on continuing and discontinuing activities were available then the forecast of the operating profits of both companies for the year to 30 September 2004 would be \$270 million (i.e. \$250 million x 108%)

Utilising the available information in the question:

| | Recall \$ million | Revival \$ million |
|--|----------------------|-----------------------|
| From continuing operations (other than acquisitions) | 189 (175 x 108%) | 216 (200 x 108%) |
| Impact of acquisitions (see below) | <u>(92)</u> | <u>108</u> |
| Net operating profit | <u>97</u> | <u>324</u> |

Recall:

Losses of \$25 million for 3 months would extrapolate to \$100 million for a full year. The improvement in market expectations would reduce these losses by 8% to \$92 million. The previous profit of \$100 million in 2003 from the financial services division would no longer be attributable to Recall as it has been sold.

Revival:

Profit of \$75 million for a nine month period would extrapolate to \$100 million plus another 8% for improved market expectations giving a total of \$108 million. The previous losses of \$25 million from its mining operations would not recur as they have been closed down.

Comments

The information on the discontinuing operations and the acquisitions is very useful. Without it, both companies would have forecast profits of \$270 million and on this basis it would be difficult to choose between the two companies. However, with the provision of the information a very different position arises. Revival has far higher forecast profits, \$324 million compared to only \$97 million for Recall. It would seem that Revival has the better strategy; it has closed down its loss-making operations and replaced it with a profitable one. Whereas Recall has sold a profitable division and bought a loss-making one. That said it does not mean that Revival is a better purchase than Recall. A lot would depend on the relative price of the two companies, and it may be that Recall has a reputation for turning round loss-making companies and then selling them on for a substantial profit.

- 4 (a) (i)** An impairment loss arises where the carrying value of an asset, or group of assets, is higher than their recoverable amounts. IAS 36 says that assets should not appear on a balance sheet at a value which is higher than they are 'worth'. The recoverable amount of an asset is defined as the higher of its net realisable value (i.e. the amount at which it can be sold for net of direct selling expenses) or its value in use (i.e. its estimated future net cash flows discounted to a present value). The Standard recognises that many assets do not produce cash flows independently and therefore the value in use may have to be calculated for a group of assets – a cash-generating unit.

The Standard recognises that it would be too onerous for companies to have to test for impaired assets every year and therefore only requires impairment reviews when there is some indication (as described in (ii) below) that an impairment has occurred. Where any of the factors described below are relevant, an enterprise needs to make a formal assessment of the recoverable amounts of the potentially affected assets. The exception to this general principle is where goodwill or other intangible assets are being depreciated over a period of more than 20 years, in which case an impairment review is required at least annually.

- (ii)** Impairments generally arise where there has been an event or change in circumstances. It may be that something has happened to the assets themselves (e.g. physical damage) or there has been a change in the economic environment relating to the assets (e.g. new regulations may have come into force).

The Standard gives several examples of indicators of impairment which may arise from external or internal sources:

- a significant decline in an asset's market value (in excess of normal depreciation through use or the passage of time);
- significant adverse changes on the enterprise. Evidence of obsolescence (through market changes or technology) or physical damage. Problems in the economic or legal environment such as the entrance of a major competitor, loss of key employees or major customers, new statutory or regulatory rules;
- evidence of a reduction in the useful economic life or estimated residual value of assets;
- increases in long-term interest rates (this could materially impact on value in use calculations thus affecting the recoverable amounts of assets);
- poor operating results. This could be a current operating loss or a low profit. A poor result for one year in itself does not necessarily mean there has been an impairment, but if there have been other recent losses or there are expected future losses then this is an indication of impairment;
- adverse changes in an indicator of value that has been used to value an asset (e.g. on acquisition a brand may have been valued on a 'multiple of sales revenues' and subsequently sales were below expectations);
- the commencement or a future commitment to a significant reorganisation or restructuring of the business is likely to have an effect on the assets that belong to that part of the business;
- where the carrying amount of an enterprise's net assets is more than its market capitalisation.

The Standard also points out that where there is an indicator of impairment, this may also indicate that there is a need to revise the life of an asset or its depreciation policy even if there is no recognised impairment.

- (b) (i)** If the company decides to replace the plant in the near future then it will only receive net sale proceeds of \$50,000. On this basis it is clear that an impairment loss of \$350,000 should be recognised.

If Avendus intends to continue to use the asset it is necessary to determine the recoverable amount of the plant. To do this would require an assessment of the value in use of the plant. As the plant does not produce independent cash flows, the recoverable amount of the cash-generation unit of which it forms part must be investigated. From the question, the cash generation unit is not impaired as its value in use is \$2 million more than its carrying value (\$7 million – \$5 million). On this basis the plant is not impaired. However as the information in the question indicates there would need to be an assessment of the depreciation policy for the plant, in particular there appears to be a need to depreciate it over a shorter estimated life.

- (ii)** This is an example of economic and market factors which may indicate impairment. The recoverable amount of the property will depend upon the company's cost of capital. Currently it is 10% per annum and at this rate the discounted cash flows from the rentals is \$168,000 ($40,000 + (40,000 \times 3 \cdot 2)$). If the expected interest rate rise occurs, this will cause the company's cost of capital to rise to 12%, and the recoverable amount of the property would fall to \$160,000 ($40,000 + (40,000 \times 3)$). IAS 36 requires the discount rate to be based on a current assessment of the time value of money, thus \$160,000 should be taken as the asset's value in use. On this basis the net realisable value of \$165,000 is higher than its value in use and an impairment loss of \$35,000 ($200,000 - 165,000$) should be recognised.

| (iii) | carrying value \$000 | impairment \$000 | restated value \$000 |
|-------------------------|-------------------------|---------------------|-------------------------|
| Goodwill | 240,000 | (240,000) | nil |
| Fishing quotas | 400,000 | not impaired | 400,000 |
| Fishing boats | 1,000,000 | (550,000) | 450,000 |
| Other fishing equipment | 100,000 | (10,000) | 90,000 |
| Fish processing plant | 200,000 | not impaired | 200,000 |
| Net current assets | 60,000 | not impaired | 60,000 |
| | 2,000,000 | (800,000) | 1,200,000 |

The impairment loss of \$800,000 (\$2 million – \$1.2 million) is first allocated to any obviously impaired assets (\$500,000 to the boats as one has been lost), then to goodwill (as it is considered an asset of subjective value), then to the remaining assets on a pro-rata basis. However no asset can be written down to less than its net realisable value, thus in this example the quotas and the fish processing plant are not impaired. As the net current assets are receivables and payables (monetary) they should not suffer any impairment. Applying this means the remaining assets to be written down are \$600,000 (boat at \$500,000 and the other fishing equipment at \$100,000) the remaining impairment loss is \$60,000 (\$800,000 – \$500,000 – \$240,000) which represents a write down of 10% (\$50,000 for the boat and \$10,000 for the other fishing equipment). The impairment exercise does not require assets that have a realisable value greater than their carrying value to be revalued upwards.

- 5 (a) Penchant – income statement extract – year to 30 September 2003 (see working below):

| | \$ million |
|-------------------|------------|
| Sales revenue | 70 |
| Cost of sales | (50) |
| | 20 |
| Profit for period | 20 |

Penchant – balance sheet extracts – as at 30 September 2003

| | |
|--|------|
| Current assets | |
| Gross amounts due from customers for contract work (w (iii)) | 23.5 |

Workings:

| (i) | cumulative 1 October 2002 \$ million | cumulative 30 September 2003 \$ million | amounts for year \$ million |
|---------------|---|--|--------------------------------|
| Sales | 110 | (w (i)) 180 | 70 |
| Cost of sales | 85 | (w (ii)) 135 | 50 |
| Profit | 25 | (w (ii)) 45 | 20 |

Progress payments received are \$161,500,000. This is 95% of the work certified (at 20 July 2003), therefore the work certified at that date is \$170 million (161.5m x 1/95). The value of the work completed between that date and 30 September 2003 is given as \$10 million, giving total contract revenue at 30 September 2003 of \$180 million.

- (ii) the total estimated profit is \$60 million:

| | \$ million |
|----------------------------|------------|
| contract price (200 + 40) | 240 |
| contract cost to date | (140) |
| estimated cost to complete | (40) |
| | 60 |
| estimated total profit | 60 |

The total revenue for the contact including the variation is \$240 million. The degree of completion (by the method given in the question) is therefore 180/240. Therefore the profit to date is \$45 million (60 x 180/240).

With recognised contract revenue of \$180 million and profit to date of \$45 million, this means contract expenses would be \$135 million.

- (iii) The gross amounts due from customers is cost to date (140) plus cumulative profit (45) less progress billings received (161.5) = \$23.5 million

- (b) (i) Events after the balance sheet date are those events, both favourable and unfavourable, that occur between the balance sheet date and the date the financial statements are authorised for issue. Traditional financial statements report the results of entities historically. On this basis, it would seem that events occurring after the balance sheet date should properly be reported in the following year's financial statements. However there are broadly two reasons why events occurring after the balance sheet date are relevant to the preparation of the preceding year's financial statements. Periodic reporting requires incomplete transactions to be incorporated in financial statements. It may be that the values of these transactions and other assets and liabilities can only be confirmed by events that happen after the year end. It is also widely recognised that although financial statements are backward looking, many users (particularly analysts) use financial statements (together with other information) to attempt to assess the future performance of the company.

Therefore the disclosure of material events occurring after the balance sheet date, even where they do not impact on balance sheet values, can be of great relevance. The first types of event are referred to as adjusting events because they provided evidence of conditions that existed at the balance sheet date and therefore require the financial statements to be adjusted to reflect the event. The second types are referred to as non-adjusting events. These are indicative of conditions that arose after the balance sheet date and do not require the financial statements to be adjusted. However where they are significant to a proper understanding of the financial position of the reporting entity, they should be disclosed by way of a note.

A notable exception to the above is where post balance sheet events indicate that the going concern of an enterprise is in doubt. Such evidence may be poor operating results, or withdrawal of credit facilities by banks etc. If such events occur it means that the enterprise should not prepare its financial statements on the going concern basis, and this will dramatically affect its reported results.

Although the above principles are quite clear, there can be practical problems with their implementation. It may be that there is post balance sheet evidence of a fall in value of an asset (say some inventory), but it is unclear whether the fall occurred before the year end or after it. If it was before, the inventory should be written down; if not it should merely be noted in the financial statements (assuming it is material).

It is also possible that more specific Standards on impairments (IAS 36) and provisions (IAS 37) may require adjustment for what are in effect events occurring after the balance sheet date.

- (ii) The discovery of the fraud is in the post balance sheet period. The effect of the fraud is that the overall profit on the contract will be \$1 million less than it should have been. It is likely, given the progression of the contract, that Penchant will have recognised some of the profit on this contract. The appropriate treatment of the discovery would be to recalculate the contract costs (based on the lower tender figure) and the contract's estimated profit. Then based on these revised costs and profit, recalculate the amount of profit recognised to 30 September 2003. Assuming it is not possible to recover the cost of the fraud from the employee or the sub-contractor, it should be charged in full (\$1 million) to the income statement for the current year to 30 September 2003.

The earthquake occurred after the balance sheet date and does not provide evidence of the values relating to the contract at 30 September 2003. The cost of the earthquake should be charged in the accounting period to 30 September 2004 (possibly as an extraordinary item) and, all other estimates remaining the same, should not affect the reported costs and revenues for the other years of the contract.

This is both an adjusting and non-adjusting event. The subsidence is almost certain to have occurred before the year end and the fall in value attributable to this of \$800,000 (\$2 million – \$1.2 million) should be charged to the income statement. The carrying value of the building should also be restated at \$11.2 million. The fall in price (\$1.2 million) due to an unexpected increase in interest rates occurring after the balance sheet date is a non-adjusting event that may require disclosure by a note if it is considered significant/material.

As the amount receivable is denominated in a foreign currency its value will change as the exchange rate changes. It may seem as if the information in the post balance sheet period is giving evidence of the value of this asset at the year end, but this is not the case. The exchange rate at the year end was good evidence of the value of the amount receivable at that date, and the gains or losses related to subsequent movements in exchange rates should be charged to the period when they occur. If the exchange loss is considered material it should be disclosed as a note of a non-adjusting event.

This marking scheme is given as a guide in the context of the suggested answers. Scope is given to markers to award marks for alternative approaches to a question, including relevant comment, and where well-reasoned conclusions are provided. This is particularly the case for written answers where there may be more than one acceptable solution.

| | | <i>Marks</i> |
|----------|---|--------------|
| 1 | property, plant and equipment | 3 |
| | investments | 2 |
| | calculation of goodwill and its depreciation – subsidiary | 4 |
| | – joint venture | 2 |
| | inventory | 2 |
| | accounts receivable | 1 |
| | bank | 1 |
| | ordinary shares | 1 |
| | share premium | 1 |
| | accumulated profits | 4 |
| | deferred tax | 2 |
| | minority interest | 4 |
| | accounts payable | 1 |
| | tax | 1 |
| | overdraft | 1 |
| | available | 30 |
| | Maximum for question | 25 |
| | | |
| 2 | (a) Income statement | |
| | sales revenue | 1 |
| | cost of sales | 7 |
| | operating expenses | 1 |
| | finance costs | 2 |
| | taxation | 1 |
| | available | 12 |
| | maximum | 10 |
| | (b) Changes in equity | |
| | share capital and premium | 2 |
| | revaluation reserve | 1 |
| | accumulated profits (1 for dividend paid) | 2 |
| | available | 5 |
| | maximum | 4 |
| | (c) Balance sheet | |
| | non-current assets | 5 |
| | current assets | 1 |
| | 8% loan note | 1 |
| | non-current liability lease | 1 |
| | current liability lease (capital) | 1 |
| | accounts payable and overdraft | 1 |
| | tax provision | 1 |
| | accrued finance costs | 1 |
| | provisions – building damage | 1 |
| | notes: – contingency | 1 |
| | available | 14 |
| | maximum | 11 |
| | Maximum for question | 25 |

| | | <i>Marks</i> |
|---|---|--------------------------------|
| 3 | (a) (i) 1 mark per relevant point to a | maximum 5 |
| | (ii) development expenditure amortisation – in 2003 | 1 |
| | – in 2002 | 1 |
| | net book value – in 2003 | 2 |
| | – in 2002 | 2 |
| | prior period adjustment | 2 |
| | | maximum 8 |
| | (b) (i) 1 mark per relevant point to a | maximum 5 |
| | (ii) forecast profits with no information | 1 |
| | applying the information 2 marks for each company suitable comments | 4 2 |
| | maximum 7 | |
| | Maximum for question 25 | |
| 4 | (a) (i) definition of impairment loss | 1 |
| | definition of recoverable amount | 1 |
| | review not required unless there are indicators goodwill/intangibles over 20 years | 1 1 |
| | | maximum 4 |
| | (ii) indicators of impairments: mark per example | maximum 6 |
| | (b) (i) if asset is to be sold impairment is \$350,000 | 1 |
| | if not sold must determine recoverable amount | 1 |
| | cannot determine it for individual asset | 1 |
| | use cash generating unit which is not impaired | 1 |
| | therefore plant not impaired | 1 |
| | need to revise depreciation policy | 1 |
| | | maximum 6 |
| | (ii) value in use at 10% and 12% 1 mark each | 2 |
| | at 10% impairment loss would be \$32,000 | 1 |
| | at 12% realisable value is recoverable amount and gives a loss of \$35,000 | 1 |
| | maximum 4 | |
| (iii) 1 mark for restated value of each item including justification | 6 | |
| | maximum 5 | |
| | Maximum for question 25 | |
| 5 | (a) value of work certified at 20 July 2003 | 1 |
| | value of work certified at 30 September 2003 | 1 |
| | estimated total profit on contract (60 m) | 1 |
| | profit to date (45 m) | 1 |
| | contract expenses to date (135 m) | 1 |
| | contract revenue for year | 1 |
| | contract expenses for year | 1 |
| | contract profit for year | 1 |
| | current assets | 2 |
| | | maximum 10 |
| | (b) (i) 1 mark per relevant point to a | maximum 5 |
| | (ii) 1 mark per relevant point to a | maximum 10 |
| | | Maximum for question 25 |