INTERNATIONAL STANDARDS INTERNATIONAL STANDARDS INTERNATIONAL

CIMA

Intermediate Level

Financial Reporting – International Accounting Standards

7b IFRI

21 May 2003

Wednesday morning

INSTRUCTIONS TO CANDIDATES

Read this page before you look at the questions

You are allowed three hours to answer this question paper.
This question paper is based on INTERNATIONAL ACCOUNTING STANDARDS. If you require the paper based on UK Accounting Standards, please speak immediately to the invigilator.
Answer the ONE question in section A (this has 10 sub-questions). Answer the ONE question in section B. Answer TWO questions ONLY from section C.
Maths Tables and Formulae were provided at the end of the questions and are available elsewhere on the wesbite.
Write your examination number in the boxes provided on the front of the answer book. Write IFRI on the line marked "Subject" on the front of the answer book. Write your examination number on the special answer sheet for section A which is on page 3 of this question paper booklet. Detach the sheet from the booklet and insert it into your answer book before you hand this in.
Do NOT write your name or your student registration number anywhere on your answer book.
Tick the appropriate boxes on the front of the answer book to indicate which questions you have answered.

SECTION A – 20 MARKS

ANSWER *ALL* TEN SUB-QUESTIONS

Each of the sub-questions numbered from **1.1** to **1.10** inclusive, given below, has only ONE correct answer.

Required:

On the SPECIAL ANSWER SHEET opposite, place a circle "O" around the letter that gives the correct answer to each sub-question.

If you wish to change your mind about an answer, block out your first answer completely and then circle another letter. You will not receive marks if more than one letter is circled.

Please note that you will not receive marks for any workings to these sub-questions.

***You must detach the special answer sheet from the question paper and attach it to the inside front cover of your answer book before you hand it to the invigilators at the end of the examination*.**

Question One

1.1 A has owned 80% of the equity shares of B since 1 January 1995. B has owned 60% of the equity shares of C since 1 January 1993. The accumulated profits of C at the latest balance sheet date (31 December 2002) stood at $30 million. The accumulated profits of C stood at $12 million on 1 January 1993 and $14 million at 1 January 1995. Ignoring goodwill, what will be included in the consolidated accumulated profits of A at 31 December 2002 in respect of C?

A $7·68 million

B $8·64 million

C $9·60 million

D $10·80 million

1.2 The following statements refer to a situation where an investing enterprise (D) seeks to exert control or influence over another enterprise (E). Assume that D is required to prepare consolidated accounts because of other investments.

(i) If D owns more than 20% but less than 50% of the equity shares in E, then E is bound to be an associate of D.

(ii) If D controls the operating and financial policies of E, then E cannot be an associate of D.

(iii) If E is an associate of D, then any amounts payable by E to D are not eliminated when preparing the consolidated balance sheet of D.

Which of the statements are true?

A (i) and (ii) only.

B (ii) only.

C (ii) and (iii) only.

D (i) and (iii) only.

1.3 F owns 70% of the equity shares of G and G owns 30% of the equity shares of H. G is a subsidiary of F and H is an associate of G. All enterprises prepare financial statements to 31 March. F has no other investments and all goodwill on consolidation has been fully amortised in previous years.

Just before 31 March 2003, G sold some goods to F and made a profit of $250,000 on the sale. These goods were in the inventory of F at 31 March 2003. This is the only trading between the enterprises during the year ended 31 March 2003. None of the enterprises has paid or proposed any dividends in the year. The profit after tax of the three enterprises in the year ended 31 March 2003 is:

- F $8 million
- G $4 million
- H $3·2 million

What is the minority interest that will be shown in the consolidated income statement of F for the year ended 31 March 2003?

A $1,125,000

B $1,200,000

C $1,413,000

D $1,488,000

1.4 J has a subsidiary, K, located in a country where the currency is the Watt. J owns all the equity shares in K and made this investment when the exchange rate was 4 Watts to $1. Summary balance sheets of K at the date of its acquisition by J and at the latest balance sheet date (31 December 2002) are:

	Date of acquisition	*Balance sheet date*
	Watts	*Watts*
Share capital	1,000,000	1,000,000
Accumulated profits	3,000,000	5,000,000
	4,000,000	6,000,000

The exchange rate at 31 December 2002 was 5 Watts to $1. Goodwill on consolidation is treated as an asset that does not vary as exchange rates fluctuate.

Ignoring write-off of goodwill, but including exchange differences, what will be included in the consolidated accumulated profits of J at 31 December 2002 in respect of K?

A $200,000

B $250,000

C $400,000

D $500,000

1.5 The consolidated financial statements of M for the year ended 31 March 2003 showed the following balances:

- Minority interest in the consolidated balance sheet at 31 March 2003 is $6 million [$3·6 million at 31 March 2002].
- Minority interest in the consolidated income statement for the year ended 31 March 2003 is $2 million.

During the year ended 31 March 2003, the group acquired a new 75% subsidiary whose net assets at the date of acquisition were $6·4 million. On 31 March 2003, the group revalued all its properties and the minority interest in the revaluation surplus was $1·5 million. There were no dividends payable to minority shareholders at the beginning or end of the year.

What is the dividend paid to the minority shareholders that will be shown in the consolidated cash flow statement of M for the year ended 31 March 2003?

A $1·2 million

B $2 million

C $2·4 million

D $2·7 million

1.6 N prepares financial statements to 31 December each year. On 30 November 2002, N entered into a binding commitment to close a division on 31 January 2003. The closure was completed on schedule and the following transactions occurred during January 2003:

(i) N incurred closure costs of $4·2 million. $3 million of this figure was direct costs and $1·2 million was apportioned head office costs.

(ii) The division made a small operating profit of $300,000.

(iii) The division sold plant and made a loss on sale of $1,000,000. This fall in value had occurred before 31 December 2002.

(iv) The division sold properties and made a profit on sale of $2,000,000.

The 2002 financial statements were approved by the directors on 20 February 2003.

What will be the charge to the income statement of N for the year ended 31 December 2002 in respect of the closure of the division?

A $2·7 million

B $4 million

C $4·2 million

D $5·2 million

1.7 P owns 75% of the equity share capital of Q and 40% of the equity share capital of R. Mr S is a director of P and Q. The only way control or significant influence can be exercised over these enterprises is by ownership of equity shares. The following statements refer to related party relationships that are subject to the disclosure requirements of IAS 24 – *Related Party Disclosures:*

(i) Q, R and Mr S are related parties of P.

(ii) Mr S is a related party of P and Q, but not of R.

(iii) Q and R are not related parties.

Which of the statements are true?

A All of them.

B (i) and (ii) only.

C (i) and (iii) only.

D (ii) and (iii) only.

1.8 T has a defined benefit pension plan and makes up financial statements to 31 March each year. The net pension liability at 31 March 2003 was $40 million ($35 million at 31 March 2002). The following additional information is relevant for the year ended 31 March 2003:

- The net pension liability at 31 March 2003 is stated before making any adjustment in respect of actuarial gains or losses arising in the year.
- No actuarial gains or losses were recognised in the income statement for the year.
- The expected return on assets was $60 million.
- The unwinding of the discount on the pension liability was $30 million.
- The current service cost was $45 million.
- The enterprise granted additional benefits to existing pensioners that vested immediately and that have a present value of $10 million. These were not allowed for in the original actuarial assumptions.
- The enterprise paid pension contributions of $40 million.

Ignoring deferred tax, what is the actuarial gain or loss arising in the year ended 31 March 2003?

A A loss of $5 million.

B A loss of $10 million.

C A loss of $20 million.

D A gain of $20 million.

1.9 On 31 December 2001, U purchased 100% of the equity share capital of V and V became a subsidiary of U on that date. U paid $110 million for the shares, and the fair value of the net assets of V at 31 December 2001 was $100 million. Goodwill on consolidation is written off over 10 years, starting in 2002. At 31 December 2002, the balance sheet of V showed the following balances:

	$ million
Property, plant and equipment:	
• Land and buildings	50
• Plant and machinery	30
Net current assets	15
	95

On 31 December 2002, the directors of U carried out an impairment review in which V was treated as a single cash-generating unit. The recoverable amount of the cash-generating unit at 31 December 2002 was computed as $96 million. No assets within the cash-generating unit had suffered obvious impairment.

What is the reduction in the consolidated reserves of U as a result of the impairment review of V (**not** including the normal annual write-off of goodwill)?

A $1 million

B $5 million

C $8 million

D $9 million

1.10 W prepares financial statements to 31 March each year. On 1 April 2002, W sold a property to a finance enterprise for $200 million. The property had a carrying value immediately before sale of $110 million and a fair value of $140 million. The property was leased back on a 10-year operating lease with annual rentals of $35 million payable in arrears.

The following statements refer to this transaction:

(i) Under current Accounting Standards, the property would no longer be a non-current asset of W following the sale and leaseback.

(ii) Under current Accounting Standards, the profit on sale of property that would be recognised immediately by W would be $30 million.

(iii) Under current Accounting Standards, the annual charge to income in respect of the property over the 10-year lease period (**excluding** any gain or loss on sale of property) would be $35 million.

Which of the above statements are true?

A None of them.

B (i) and (ii) only.

C (i) and (iii) only.

D (ii) and (iii) only.

(Total = 20 marks)

SECTION B – 30 MARKS
ANSWER THIS QUESTION

Question Two

You are the Management Accountant of Pot, an enterprise which prepares consolidated financial statements in accordance with International Accounting Standards. The enterprise has investments in two other enterprises, Bill and Den. The income statements of all three enterprises for the year ended 31 December 2002 (the accounting reference date for all three enterprises) are given below.

	Pot	*Bill*	*Den*
	$000	*$000*	*$000*
Revenue	30,000	32,000	28,000
Cost of sales	(15,000)	(16,000)	(14,000)
Gross profit	15,000	16,000	14,000
Other operating expenses	(8,000)	(8,500)	(6,000)
Profit from operations	7,000	7,500	8,000
Investment income:			
Bill	600		
Den	600		
Finance costs	(1,000)	(1,200)	(1,000)
Profit before tax	7,200	6,300	7,000
Income tax expense	(1,900)	(1,900)	(2,000)
Profit for the period	5,300	4,400	5,000

Note 1 – Investments by Pot in Bill
These have been as follows:

Date	*% of equity shares purchased*	*Price paid*	*Net assets at date of purchase*	
			Book value	*Fair value*
		$000	*$000*	*$000*
1 July 1997	30	8,200	24,000	26,000
1 July 2002	40	13,400	30,000	31,000

The differences between the book values and the fair values of the net assets at the date of investment by Pot were caused by:

- Land – in the case of the difference of $2 million arising on the first investment.
- Plant with an estimated future useful economic life of 5 years from 1 July 2002 – in the case of the difference of $1 million arising on the second investment. Bill charges the depreciation of its plant on a monthly basis to other operating expenses.

Note 2 – Investment by Pot in Den
This was as follows:

Date	*% of equity shares purchased*	*Price paid*	*Net assets at date of purchase*	
			Book value	*Fair value*
		$000	*$000*	*$000*
1 January 1995	80	14,800	16,000	17,000

All of the net assets that caused the fair value adjustment at 1 January 1995 were sold or scrapped prior to 31 December 2001.

Note 3 – Dividends paid in the period (all on 31 May 2002):

Pot	$3,000,000
Bill	$2,000,000
Den	$1,500,000

Note 4 – Accounting policy regarding purchased goodwill

Pot amortises all purchased goodwill on a monthly basis over its estimated useful economic life. For the acquisitions of Bill and Den, this estimate was 10 years. Goodwill on acquisition of subsidiaries is amortised through cost of sales.

Note 5 – Sale of shares in Den

On 1 April 2002 (when the net assets of Den had a book value of $25 million), Pot sold half its shares in Den for a total of $14 million. Tax of $1,500,000 was estimated to be payable on the disposal. The income statement of Pot that is shown on page 10 does NOT include the effects of this disposal.

Note 6 – Intra-group sales

- From 1 July 2002, Pot supplied goods to Bill at a mark up of 25% on cost. Pot supplied goods of the same type to Den until 31 March 2002.
- Details of the sales by Pot to Bill and Den are given below:

Name of enterprise	*Purchases from Pot in 2002*	*Amounts included in inventories at*	
		31 December 2002	*31 December 2001*
	$000	*$000*	*$000*
Bill	6,000	600	Nil
Den	4,000	Nil	800

Apart from these intra-group sales and the payments of dividends, there were no other transactions between the three enterprises.

Note 7 – Accounting policy regarding fair value adjustments

In preparing its consolidated financial statements, Pot follows the allowed alternative treatment that is included in IAS 22 – *Business Combinations*.

Required:

(a) Explain how Bill and Den will be treated in the consolidated income statement of Pot for the year ended 31 December 2002.

(5 marks)

(b) Prepare the consolidated income statement of the Pot group for the year ended 31 December 2002. Do NOT prepare notes to the financial statements. Prepare all calculations to the nearest $000.

(25 marks)

(Total = 30 marks)

SECTION C – 50 MARKS

ANSWER TWO QUESTIONS ONLY

Question Three

You are the Management Accountant of Drax. The enterprise prepares financial statements to 31 March each year. Earnings per share is regarded as a key performance indicator and the executive directors receive a bonus if the earnings per share exceeds a given target figure. Good corporate governance is ensured by the appointment of a number of non-executive directors, who rigorously scrutinise the financial statements each year to ensure that the earnings per share figure has been correctly computed.

Drax has recently appointed a new non-executive director who seeks your advice regarding the financial statements for the year ended 31 March 2003. Extracts from these financial statements (excluding the comparative figures) are given below. The financial statements comply with relevant Accounting Standards in all material respects.

STATEMENTS OF FINANCIAL PERFORMANCE:

Income statement – year ended 31 March 2003

	Continuing operations	*Discontinuing operations*	*Total*
	$ million	*$ million*	*$ million*
Revenue	1,000	100	1,100
Cost of sales	(520)	(70)	(590)
Gross profit	480	30	510
Other operating expenses	(200)	(40)	(240)
Profit from operations	280	(10)	270
Loss on disposal of discontinuing operations (*Note 1*)	–	(30)	(30)
Profit before finance costs	280	(40)	240
Finance costs			(55)
Profit before tax			185
Income tax expense			(55)
Profit after tax			130
Minority interests			(45)
Group profit for the period			85

Earnings per equity share 59·13 cents

Statement of changes in equity – year ended 31 March 2003

	$ million	*$ million*
Balance at 1 April 2002		270
Profit for the financial year		85
Unrealised surplus on the revaluation of properties		22
Currency translation differences on foreign currency net investments	12	
Less exchange losses on related foreign currency loans	(9)	
		3
Dividends (all equity)		(50)
Issue of share capital (*Note 2*)		60
Balance at 31 March 2003		390

NOTES TO THE FINANCIAL STATEMENTS:

Note 1

During the year, Drax disposed of a subsidiary. The loss on disposal shown in the income statement consists of two elements:

- Disposal proceeds less related net assets less related goodwill $45 million **loss**
- Gain on curtailment of retirement benefits relating to disposal $15 million **profit**.

Note 2

At the start of the period, Drax had 120 million $1 equity shares in issue. Drax had no non-equity shares. On 1 July 2002, Drax made a rights issue to existing shareholders of one share for every four held at $2 per share. The market value of each share immediately before the rights issue was $2·50.

Note 3 – Defined benefit pension plan

	At 31 March 2003	*At 31 March 2002*
	$ million	*$ million*
Present value of funded obligations	5,000	4,500
Fair value of plan assets	(2,600)	(2,700)
Unrecognised actuarial losses	(380)	(350)
Net liability in balance sheet	2,020	1,450

The new non-executive director has sent you a list of questions to which he requires answers:

(a) Please show how the earnings per share figure has been computed. *(5 marks)*

(b) I am a non-executive director for another enterprise operating in the same industry as Drax with roughly the same revenue and with very similar unit costs of raw materials. The nominal value of the shares of this other enterprise is $1 yet its earnings per share is quite different from that of Drax. How can this be? *(6 marks)*

(c) I am very suspicious about some of the figures in the statement of changes in equity and in the pension plan liability. It would seem to me that exchange losses on loans and actuarial losses relating to the pension plan should be in the income statement. Are the executive directors trying to maximise the earnings per share for their own ends? *(9 marks)*

(d) I don't understand how the "gain on curtailment of retirement benefits" is a gain that goes to the income statement. Shouldn't it be treated in the same way as the actuarial losses that seem to be included in the balance sheet figure for the pension plan liability? *(5 marks)*

Required:

Prepare a reply to the questions the non-executive director has raised. You should refer to the provisions of relevant Accounting Standards where appropriate. Assume that the non-executive director has a reasonable general knowledge of business but that he is not familiar with the detail of Accounting Standards.

(Total = 25 marks)

Question Four

You are the Chief Accountant of Kirk. The enterprise prepares consolidated financial statements in accordance with International Accounting Standards. Your assistant has prepared the first draft of the financial statements for the year ended 31 December 2002.

Your assistant is unqualified and her knowledge of Accounting Standards is incomplete. Therefore she has listed three issues that came to her attention when preparing the first draft of the statements.

Issue (a)

A 100% subsidiary regularly supplies goods on a sale or return basis. The terms of sale are that the customer has the right to return goods supplied in month 1 at any time before the end of month 2. Past history suggests that customers have exercised this right on a number of occasions. Payment for goods not returned is due at the end of month 3.

The revenue figure in the draft financial statements is based on the goods actually supplied in the period. The sales values of goods supplied on a sale or return basis in December 2001 and December 2002 were as follows:

- $20 million in December 2001.
- $30 million in December 2002.

The subsidiary earns a margin of 20% on the selling price of all the goods supplied on a sale or return basis. None of the goods that were delivered in December 2001 were returned in January 2002.

Issue (b)

An 80% subsidiary joined the group on 1 January 1998. The fair value of the consideration given was $66 million and the fair value of the net assets of the subsidiary at 1 January 1998 was $70 million. After a period of successful trading, the subsidiary experienced some operational difficulties in 2002, and at 31 December 2002 it was reviewed for impairment as a single cash-generating unit. The carrying value of the separable net assets of the subsidiary in the consolidated accounts at 31 December 2002 was $80 million. This included obsolete plant that had a carrying value of $5 million. The results of the review were that the separable net assets at 31 December 2002 had a value in use of $79 million and a net realisable value of $75 million. Your assistant has ignored the results of the review in preparing the draft financial statements. Group policy is to amortise goodwill over 10 years to cost of sales. The amortisation charge for 2002 has been incorporated into the draft financial statements. Unamortised goodwill is shown in intangible non-current assets.

Issue (c)

On 1 January 2002, a 60% subsidiary sold a leasehold interest in a property to a bank for $100 million. The property was carried in the financial statements at $80 million and the remaining term of the lease was 20 years from 1 January 2002. The terms of sale were that the subsidiary has the option to repurchase the leasehold interest on 31 December 2002, 2003 or 2004 at the following prices:

- 31 December 2002 $110 million
- 31 December 2003 $121 million
- 31 December 2004 $133 million.

If none of the options is exercised, the subsidiary is obliged to repurchase the interest on 31 December 2005 for $146 million. The option was not exercised on 31 December 2002.

Your assistant has credited the sales proceeds to a suspense account that is included in current liabilities. In previous years, the leasehold property has been amortised over the lease term with the amortisation expense included in cost of sales. However, no amortisation charge has been made for 2002 on the grounds that the leasehold interest has been disposed of on the first day of the year.

Required:

Explain the adjustments that would be required to correctly reflect each of *issues (a, (b))* and *(c)* in the consolidated financial statements of Kirk for the year ended 31 December 2002. You should provide appropriate journal entries to support your adjustments. Refer to the provisions of Accounting Standards where relevant. Where no Accounting Standard exists, you should refer to underlying accounting principles to support your argument.

The allocation of marks is:	*Issue (a)*	*(9 marks)*
	Issue (b)	*(7 marks)*
	Issue (c)	*(9 marks)*

Ignore the potential tax effects of any adjustments you make.

(Total = 25 marks)

Question Five

Small was incorporated in 1985 and prior to its acquisition by Big had built up its own customer base and local supplier network. This was not disturbed when Small became a subsidiary of Big as the directors of Big were anxious that the local expertise of the management of Small should be utilised as much as possible. Therefore all the day-to-day operational decisions regarding Small continued to be made by the existing management, with the directors of Big exercising "arms' length" strategic control.

The balance sheets of Big and Small at 31 March 2003 are given below. The balance sheet of Small is prepared in florins, the reporting currency for Small.

	Big		*Small*	
	$000	*$000*	*Fl'000*	*Fl'000*
Non-current assets:				
Property, plant and equipment	60,000		80,000	
Investments	9,500			
		69,500		80,000
Current assets:				
Inventories	30,000		40,000	
Trade receivables	25,000		32,000	
Cash	3,000		4,000	
		58,000		76,000
		127,500		156,000
Issued capital and reserves:				
Called up share capital (50 cents / $^1/_2$ florin shares)		30,000		40,000
Revaluation reserve		15,000		–
Accumulated profits		34,500		44,000
		79,500		84,000
Non-current liabilities:				
Interest-bearing borrowings	15,000		30,000	
Deferred tax	5,000		9,000	
		20,000		39,000
Current liabilities:				
Trade payables	12,000		15,000	
Tax	16,000		18,000	
		28,000		33,000
		127,500		156,000

NOTES TO THE BALANCE SHEETS

Note 1 – Investment by Big in Small

On 1 April 1997, Big purchased 60 million shares in Small for 57 million florins. The accumulated profits of Small showed a balance of 20 million florins at that date. The accounting policies of Small are the same as those of Big except that Big revalues its land, whereas Small carries its land at historical cost. Small's land had been purchased on 1 April 1994. On 1 April 1997, the fair value of the land of Small was 6 million florins higher than its carrying value in the individual financial statements of that enterprise. By 31 March 2003, the difference between fair value and carrying value had risen to 11 million florins. Apart from this accounting policy difference, no other fair value adjustments were necessary when initially consolidating Small as a subsidiary. Goodwill on acquisition is amortised over 10 years and is treated as an asset that does not vary as exchange rates fluctuate.

Note 2 – Intra-group trading

On 6 March 2003, Big sold goods to Small at an invoiced price of $6,000,000, making a profit of 25% on cost. Small recorded these goods in inventory and payables using an exchange rate of 5 florins to $1 (there were minimal fluctuations between the two currencies in the month of March 2003). The goods remained in the inventory of Small at 31 March 2003 but on 29 March 2003 Small sent Big a cheque for 30 million florins to clear its payable. Big received and recorded this cash on 3 April 2003.

Note 3 – Exchange rates

Date	*Exchange rate (florins to $1)*
1 April 1994	7
1 April 1997	6
31 March 2002	5·5
31 March 2003	5
Weighted average for the year to 31 March 2003	5·2
Weighted average for the dates of acquisition of closing inventory	5·1

Required:

(a) Explain (with reference to appropriate Accounting Standards to support your argument) how the financial statements (balance sheet and income statement) of Small should be translated into $s for the consolidation of Big and Small.

(5 marks)

(b) Translate the balance sheet of Small at 31 March 2003 into $s and prepare the consolidated balance sheet of the Big group at 31 March 2003.

(20 marks)

(Total = 25 marks)

Question Six

There is currently no single International Accounting Standard that deals with the issue of reporting financial performance. In 1997, the International Accounting Standards Committee (IASC) issued IAS 1 (revised) – *Presentation of Financial Statements.* The Standard basically deals with the components, structure and content of financial statements. In 1993, the IASC issued IAS 8 – *Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies.* The key objective of this International Accounting Standard was to ensure that "unusual" items are presented in the income statement on a consistent basis. In 1998, the IASC issued IAS 35 – *Discontinuing Operations*, which dealt with their presentation and disclosure.

Despite the existence of three International Accounting Standards on the subject, the IASC concluded that further development in the area of reporting financial performance was appropriate and began a project in conjunction with the UK Accounting Standards Board (ASB). A draft UK financial reporting standard – FRED 22: *Revision of FRS 3 reporting financial performance* was published by the ASB in December 2000. The draft Standard proposes the development of a single statement of financial performance with recycling of gains and losses between different sections of the statement being prohibited. The International Accounting Standards Board (IASB) – the successor organisation to the IASC – is monitoring reaction to FRED 22 very closely with a view to developing an international financial reporting standard along similar lines to FRED 22.

You are the Management Accountant of Strobe, an enterprise that prepares financial statements in accordance with International Accounting Standards. Your assistant has identified three transactions of the enterprise that have arisen in the year ended 31 December 2002 whose treatment may be affected should a new Financial Reporting Standard be issued in line with the current thinking of the IASB.

Transaction 1

On 30 November 2002, Strobe entered into a binding commitment to close down a business segment in 2003. The closure was completed on 30 April 2003 and the direct costs of closure totalled $15 million. This figure comprised:

- Redundancy costs and associated professional fees $16 million
- Losses on the sale of plant and machinery $4 million
- Profits on the sale of properties $5 million

Transaction 2

On 31 October 2002, Strobe sold a foreign subsidiary that was consolidated using the net investment method. At the date of disposal, the consolidated accumulated profits of Strobe included cumulative gains on retranslation of the net assets of the subsidiary amounting to $7 million.

Transaction 3

From 2002, Strobe changed its accounting policy regarding finance costs relating to constructed non-current assets. The previous policy had been to write off all costs in the income statement as incurred. The finance costs that were included in non-current assets at 31 December 2002 totalled $25 million. Had the new policy been in place during the year ended 31 December 2001, the finance costs included in non-current assets at 31 December 2001 would have been $20 million. The change in accounting policy did not affect the timing of current tax relief available on the finance costs, which is given as the costs are incurred. The appropriate rate of tax in the jurisdiction in which Strobe operates is 30%.

Required:

(a) Explain why the IASC considered it necessary to commission further work on the reporting of financial performance when there were already three International Accounting Standards dealing with the issue.

(6 marks)

(b) Evaluate the effect on current accounting practice of prohibiting the recycling of gains and losses.

(5 marks)

(c) Show the effect of the three transactions highlighted by your assistant on the income statement and the statement of changes in equity for the year ended 31 December 2002 under *existing* International Accounting Standards.

(9 marks)

(d) Discuss the contribution that joint projects between the IASB and domestic Standard setters can make to the development of global financial reporting.

(5 marks)

(Total = 25 marks)

End of paper