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THE INSTITUTE OF CHARTERED ACCOUNTANTS OF SRI LANKA

No of pages:11

Strategic Level

Advanced Business Reporting (SL 1)

Instructions to candidates

(1) Time allowed: Reading and planning – 15minutes
Writing – 3 hours

(2) Total: 100 marks

(3) Answer all questions.

(4) This paper consists of two sections.
Section 1: 2 questions
Section 2: 1 question (The common pre-seen provided prior to the examination is in relation to this question)

(5) Answers should be in the English Language, in the answer booklet/s given to you.

(6) Begin each answer on a separate page in the answer booklet. Submit all workings.

(7) The examination will be conducted as an open book examination and only the following publications of CA Sri Lanka will be permitted to be used at the examination hall:

- Sri Lanka Accounting Standards 2020
- Open Book Referential - Student Version (Sri Lanka Statement of Recommended practice, IFRICs and SICs)
- Sri Lanka Auditing Standards & Sri Lanka Standard on Quality Control (2020 Edition - Volume 01)
- Sri Lanka Standards on other Assurance Engagements and Related Services (2020 Edition - Volume 02)
- Sri Lanka Framework for Audit Quality and Sri Lanka Framework for Assurance Engagements (2020 Edition -Volume 03)
- Code of Best Practice on Corporate Governance 2017
- A Guide to Corporate Governance in Small and Medium Enterprises 2019
- Code of Ethics 2016
- Sri Lanka Accounting Standard for SMEs 2015
- Sri Lanka Accounting Standard for Smaller Entities - 2015

(8) Students are allowed to bring permitted publications that are highlighted, sidelined, or underlined. Short notes written on the permitted publications will also be allowed. Page tags may be used to refer to the pages. Short notes pasted on the permitted publications are not allowed.

(9) Notes, textbooks (other than permitted publications), or any other material will not be allowed. Photocopies/extracts of the above publications will not be allowed.

(10) Answers that are written on the answer booklets, graph papers, and any other stationery distributed at the examination hall, only, are considered when marking of the answer scripts. Any other attached documents are not taken into account at the time of marking the answer scripts.

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July 2023

Model Paper 01

Samira Anthony

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Section 1

Question 01

Paint has several investments in subsidiary companies. On 1 July 20X1, it acquires 30% of the ordinary shares of Animate for $2m. This holding gives Paint significant influence over Animate. At the acquisition date, the fair value of Animate's net assets approximate to their carrying values with the exception of a building. This building, with a remaining useful life of 10 years, had a carrying value of $1m but a fair value of $1.8m.

Between 1 July 20X1 and 31 December 20X1, Animate sold goods to Paint for $1 million making a profit of $100,000. All of these goods remain in the inventory of Paint. This sale was made on credit and the invoice has not yet been settled.

Animate made a profit after tax of $800,000 for the year ended 31 December 20X1. At 31 December 20X1, the directors of Paint believe that the investment in the associate needs impairing by $50,000.

Required

(a) Prepare extracts from the consolidated statement of financial position and the consolidated statement of profit or loss showing the treatment of the associate for the year ended 31 December 20X1. (10 marks)

Horizon Constructions PLC (HC) is a large construction company. It has direct and indirect investments in subsidiaries and an investment in an associate company. HC has formed an audit committee that wholly consists of non-executive directors. An audit committee charter has been developed by HC.

HC transacts with subsidiaries, associates and other affiliated entities. Further, HC has entered into construction contracts with third party entities, whose key management personnel are related to two directors of HC. In the previous year, the external auditors identified and rectified incomplete disclosures made on related party transactions in the annual report of HC.

At a board meeting, the board of directors became aware of the new rules issued by the Securities and Exchange Commission of Sri Lanka (SEC) on related party transactions. The finance director stated that the audit committee should ensure the compliance with these new rules and also review the related party transactions of HC.

Required

(c) **Validate** the finance director's statement about the audit committee's responsibility for ensuring compliance with the new rules issued by the SEC on related party transactions and on the review of related party transactions. (7 marks)

(b) **Advise** the directors of HC regarding the process that should be in place to identify and disclose the related party transactions of HC. (8 marks)

(Total 25 marks)

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Question 02

On 1 January 20X8 an entity purchased equity instruments for their fair value of $900,000. They were designated upon initial recognition to be classified as fair value through other comprehensive income.

At 30 September 20X8, the equity instrument was still worth $900,000 but the entity became worried about the risk of a decline in value. It therefore entered into a futures contract to sell the shares for $900,000 in six months' time. It identified the futures contract as a hedging instrument as part of a fair value hedging arrangement. The fair value hedge was correctly documented and designated upon initial recognition. All effectiveness criteria have been complied with.

By the reporting date of 31 December 20X8, the fair value of the equity instrument had fallen to $800,000, and the fair value of the futures contract had risen by $90,000.

Required:

Required

(a) Explain the accounting treatment of the fair value hedge arrangement based upon the available information.

(5 marks)

Chive has a firm commitment to buy an item of machinery for CU2m on 31 March 20X2. The Directors are worried about the risk of exchange rate fluctuations.

On 1 October 20X1, when the exchange rate is CU2:$1, Chive enters into a futures contract to buy CU2m for $1m on 31 March 20X2. At 31 December 20X1, CU2m would cost $1,100,000.

The fair value of the futures contract has risen to $95,000. All effectiveness criteria have been complied with.

Required

(b) Explain the accounting treatment of the above in the financial statements for the year ended 31 December 20X1 if:

(i) Hedge accounting was not used.

(ii) On 1 October 20X1, the futures contract was designated as a fair value hedge of the movements in the fair value of the firm commitment to purchase the achine. (10 marks)

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An entity, Splash, established a share option scheme for its four directors. This scheme commenced on 1 July 20X8. Each director will be entitled to 25,000 share options on condition that they remain with Splash for four years, from the date the scheme was introduced.

Information regarding the share options is provided below:

Fair value of option at grant date $10

Exercise price of option $5

The fair value of the shares at 30 June 20X9 was $17 per share.

A tax deduction is only given for the share options when they are exercised. The allowable deduction will be based on the intrinsic value of the options. Assume a tax rate of 30%.

Required

(c) Calculate and explain the amounts to be included in the financial statements of Splash for the year ended 30 June 20X9, including explanation and calculation of any deferred tax implications.

(10 marks)

(Total 25 Marks)

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Section 2

Question 03

The following are extracts from the consolidated financial statements of the Moyes group.
Group statement of profit or loss for the year ended 30 September 20X8:

	$m
Revenue	612
Cost of sales	(347)
Gross profit	265
Operating expenses	(123)
Share of profit of associate	67
Profit before tax	209

Extracts from the group statement of financial position:

	30 September 20X8	30 September 20X7
$m $m		
Inventories	126	165
Trade receivables	156	149
Trade payables	215	197

The following information is also relevant to the year ended 30 September 20X8:

Pension scheme

Moyes operates a defined benefit scheme. A service cost component of $24 million has been included within operating expenses. The remeasurement component for the year was a gain of $3 million. Benefits paid out of the scheme were $31 million. Contributions into the scheme by Moyes were $15 million.

Goodwill

Goodwill was reviewed for impairments at the reporting date. Impairments arose of $10 million in the current year.

Property, plant and equipment

Property, plant and equipment (PPE) at 30 September 20X8 included cash additions of $134 million.

Depreciation charged during the year was $99 million and an impairment loss of $43 million was recognised. Prior to the impairment, the group had a balance on the revaluation surplus of $50 million of which $20 million related to PPE impaired in the current year.

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Inventory

Goods were purchased for Dinar 80 million cash when the exchange rate was $1:Dinar 5. Moyes had not managed to sell the goods at 30 September 20X8 and the net realisable value was estimated to be Dinar 60 million at 30 September 20X8. The exchange rate at this date was $1:Dinar 6. The inventory has been correctly valued at 30 September 20X8 with both the exchange difference and impairment correctly included within cost of sales.

Changes to group structure

During the year ended 30 September 20X8, Moyes acquired a 60% subsidiary, Davenport, and also sold all of its equity interests in Barham for cash. The consideration for Davenport consisted of a share for share exchange together with some cash payable in two years. 80% of the equity shares of Barham had been acquired several years ago but Moyes had decided to sell as the performance of Barham had been poor for several years. Consequently, Barham had a substantial overdraft at the disposal date. Barham was unable to pay any dividends during the financial year but Davenport did pay an interim dividend on 30 September 20X8.

Discontinued operations

The directors of Moyes wish for advice as to whether the disposal of Barham should be treated as a discontinued operation and separately disclosed within the consolidated statement of profit or loss. There are several other subsidiaries which all produce similar products to Barham and operate in a similar geographical area. Additionally, Moyes holds a 52% equity interest in Watson. Watson has previously issued share options to other entities which are exercisable in the year ending 30 September 20X9. It is highly likely that these options would be exercised which would reduce Moyes' interest to 35%. The directors of Moyes require advice as to whether this loss of control would require Watson to be classified as held for sale and reclassified as discontinued.

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Required

(a) Draft an explanatory note to the directors of Moyes which should include:

(i) A calculation of cash generated from operations using the indirect method; and
(ii) An explanation of the specific adjustments required to the group profit before tax to calculate the cash generated from operations.
Note. Any workings can either be shown in the main body of the explanatory note or in an appendix to the explanatory note. (12 marks)

(b) Explain how the changes to the group structure and dividend would impact upon the consolidated statement of cash flows at 30 September 20X8 for the Moyes group. You should not attempt to alter your answer to Part (a). (6 marks)

(c) Advise the directors as to whether Watson should be classified as held for sale and whether both it and Barham should be classified as discontinued operations. (6 marks)

Hill is a public limited company which has investments in several other entities. All of these entities prepare their financial statements in accordance with International Financial Reporting Standards. Extracts from the draft individual statements of profit or loss for Hill, Chandler and Doyle for the year ended 30 September 20X6 are presented below.

	Hill	Chandler	Doyle
	$m	$m	$m
Profit/(loss) before taxation	(45)	67	154
Taxation	9	(15)	(31)
Profit/(loss) for the period	(36)	52	123

Acquisition of 80% of Chandler

Hill purchased 80% of the ordinary shares of Chandler on 1 October 20X5. Cash consideration of $150 million has been included when calculating goodwill in the consolidated financial statements.

The purchase agreement specified that a further cash payment of $32 million becomes payable on 1 October 20X7 but no entries have been posted in the consolidated financial statements in respect of this. A discount rate of 5% should be used.

In the goodwill calculation, the fair value of Chandler's identifiable net assets was deemed to be $170 million. Of this, $30 million related to Chandler's non-depreciable land. However, on 31 December 20X5, a survey was received which revealed that the fair value of this land was only $20 million as at the acquisition date. No adjustments have been made to the goodwill calculation in respect of the results of the survey. The non-controlling interest at acquisition was measured using the proportionate method as $34 million ($170m × 20%).

As at 30 September 20X6, the recoverable amount of Chandler was calculated as $250 million. No impairment has been calculated or accounted for in the consolidated financial statements.

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Disposal of 20% holding in Doyle

On 1 October 20X4, Hill purchased 60% of the ordinary shares of Doyle. At this date, the fair value of Doyle's identifiable net assets was $510 million. The non-controlling interest at acquisition was measured at its fair value of $215 million. Goodwill arising on the acquisition of Doyle was $50 million and had not been impaired prior to the disposal date. On 1 April 20X6, Hill disposed of a 20% holding in the shares of Doyle for cash consideration of $140 million. At this date, the net assets of Doyle, excluding goodwill, were carried in the consolidated financial statements at $590 million. From 1 April 20X6, Hill can appoint two of the six members of Doyle's board of directors. The fair value of Hill's 40% shareholding was $300 million at that date.

Issue of convertible bond

On 1 October 20X5, Hill issued a convertible bond at par value of $20 million and has recorded it as a non-current liability. The bond is redeemable for cash on 30 September 20X7 at par. Bondholders can instead opt for conversion in the form of a fixed number of shares. Interest on the bond is payable at a rate of 4% a year in arrears. The interest paid in the year has been presented in finance costs. The interest rate on similar debt without a conversion option is 10%.

Discount factors

Year	Discount rate 5%	Discount rate 10%
1	0.952	0.909
2	0.907	0.826

Required

Required

(a)

(i) In respect of the investment in Chandler, explain, with suitable calculations, how goodwill should have been calculated, and show the adjustments which need to be made to the consolidated financial statements for this as well as any implications of the recoverable amount calculated at 30 September 20X6. (13 marks)

(ii) Discuss, with suitable calculations, how the investment in Doyle should be dealt with in the consolidated financial statements for the year ended 30 September 20X6. (7 marks)

(iii) Discuss, with suitable calculations, how the convertible bond should be dealt with in the consolidated financial statements for the year ended 30 September 20X6, showing any adjustments required. (6 marks)

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