
Answers

Section A

1 D

The substance is that there is no 'free' finance; its cost, as such, is built into the selling price.

2 B

A new process may produce benefits (and therefore be recognised as an asset) other than increased revenues, e.g. it may reduce costs.

3 A

A board decision to discontinue an operation does not create a liability. A provision can only be made on the announcement of a formal plan (as it then raises a valid expectation that the discontinuance will be carried out). As this announcement occurs during the year ended 31 March 2016, this a non-adjusting event for the year ended 31 March 2015.

4 C

Is the lower of its carrying amount (\$217,000) and recoverable amount (\$214,600) at 31 March 2015.
Recoverable amount is the higher of value in use (\$214,600) and fair value less (any) costs of disposal (\$200,000).
Carrying amount = \$217,000 (248,000 – (248,000 x 12.5%))
Value in use is based on present values = \$214,600

5 C

Market price of Sact's shares at acquisition was \$2.50 (3.00 – (3.00 x 20/120)), therefore NCI at acq was \$50,000 (100,000 x 20% x \$2.50). NCI share of the post-acq profit is \$6,000 (40,000 x 9/12 x 20%). Therefore non-controlling interest as at 31 March 2015 is \$56,000.

6 B

By definition irredeemable preference shares do not have a contractual obligation to be repaid and thus do not meet the definition of a liability; they are therefore classed as equity.

7 D

Is correct as it will increase debt but have no effect on equity.

8 C

9 A

Six months' depreciation is required on the building structure and air conditioning system.

	\$'000
Land (not depreciated)	2,000
Building structure (10,000 – (10,000/25 x 6/12))	9,800
Air conditioning system (4,000 – (3,500/10 x 6/12))	3,825
	<u>15,625</u>

10 B

11 D

Retained earnings:

	\$
Wilmslow	450,000
Post acq Zeta ((340 – 200) x 80%)	112,000
URP in inventory (320,000 x ¼ x 25/125)	(16,000)
	<u>546,000</u>

12 C

The fair value of deferred consideration is its present value (i.e. discounted).

13 C

Six months' depreciation to the date of the revaluation will be \$300,000 (12,000/20 years x 6/12); six months' depreciation from the date of revaluation to 31 March 2015 would be \$400,000 (10,800/13.5 years remaining life x 6/12). Total depreciation is \$700,000.

14 A

(i) is the only correct elimination required by IFRS.

15 B

16 D

(iv) deferred tax relating to the revaluation of an asset must be provided for even if there is no intention to sell the asset in accordance with IAS 12.

17 A

The property would be depreciated by \$25,000 (800,000/16 x 6/12) for six months giving a carrying amount of \$775,000 (800,000 – 25,000) before being classified as held-for-sale. This would also be the value at 31 March 2015 as it is no longer depreciated and is lower than its fair value less cost to sell.

18 A

	\$'000	
Investment at cost	1,200	
Share of post-acq profit	150	(750 x 8/12 x 30%)
URP in inventory	(15)	(300 x 20/120 x 30%)
	<u>1,335</u>	

19 D

At 31 March 2015, the deferred consideration of \$12,650 would need to be discounted by 10% for one year to \$11,500 (effectively deferring a finance cost of \$1,150). The total amount credited to profit or loss would be \$24,150 (12,650 + 11,500).

20 C

Is correct as use of average cost gives a higher cost of sales (and in turn lower operating profit) than FIFO during rising prices.

Section B

1 (a) Bycomb: Goodwill on acquisition of Cyclip as at 1 July 2014

	\$'000	\$'000
Investment at cost:		
Shares (12,000 x 80% x 2/3 x \$3.00)		19,200
Deferred consideration (12,000 x 80% x \$1.54/1.1)		13,440
Non-controlling interest (12,000 x 20% x \$2.50)		<u>6,000</u>
		38,640
Net assets (based on equity) of Cyclip as at 1 July 2014		
Equity shares	12,000	
Retained earnings b/f at 1 April 2014	13,500	
Earnings 1 April to acquisition: (2,400 + 100 x 3/12) – see note below	625	
Fair value adjustment to plant	<u>720</u>	
Net assets at date of acquisition		<u>(26,845)</u>
Consolidated goodwill		<u>11,795</u>

Note: The profit for the year for Cyclip would be increased by \$100,000 due to interest capitalised, in accordance with IAS 23 *Borrowing Costs*. Alternatively, this could have been calculated as: $2400 \times 3/12 + 25$. As the interest to be capitalised has accrued evenly throughout the year, \$25,000 would relate to pre-acquisition profits and \$75,000 to post-acquisition profits.

(b) Bycomb: Extracts from consolidated statement of profit or loss for the year ended 31 March 2015

	\$'000
(i) Revenue (24,200 + (10,800 x 9/12) – 3,000 intra-group sales)	29,300
(ii) Cost of sales (w (i))	(20,830)
(iii) Finance costs (w (ii))	(1,558)
(iv) Profit for year attributable to non-controlling interest (1,015 x 20% (w (iii)))	203

Workings in \$'000

(i) Cost of sales

Bycomb	17,800
Cyclip (6,800 x 9/12)	5,100
Intra-group purchases	(3,000)
URP in inventory (420 x 20/120)	70
Impairment of goodwill per question	500
Additional depreciation of plant (720 x 9/18 months)	<u>360</u>
	<u>20,830</u>

(ii) Finance costs

Bycomb per question	400
Unwinding of deferred consideration (13,440 x 10% x 9/12)	1,008
Cyclip ((300 – 100 see below) x 9/12)	<u>150</u>
	<u>1,558</u>

The interest capitalised in accordance with IAS 23 of \$100,000 would reduce the finance costs of Cyclip for consolidation purposes.

(iii) Post-acquisition profit of Cyclip

Profit plus interest capitalised and time apportioned ((2,400 + 100) x 9/12) – see note below	1,875
Impairment of goodwill (per question)	(500)
Additional depreciation of plant (w (i))	<u>(360)</u>
	<u>1,015</u>

Note: This could also have been calculated as $(2,400 \times 9/12) + 75$ (see 1(a) above).

2 Note: References to 2015 and 2014 refer to the periods ended 31 March 2015 and 2014 respectively.

(a) Calculation of equivalent ratios (figures in \$'000):

	(i) 2014 excluding division	(ii) 2015 as reported	2014 per question
Gross profit margin $((20,000 - 8,000)/(50,000 - 18,000) \times 100)$	37.5%	33.3%	40.0%
Operating profit margin $((11,800 - 5,800)/32,000 \times 100)$	18.8%	10.3%	23.6%
Return on capital employed (ROCE) $((11,800 - 5,800)/(29,200 - 7,200 - 7,000 \text{ see below}) \times 100)$	40.0%	21.8%	53.6%
Net asset turnover $(32,000/15,000)$	2.13 times	2.12 times	2.27 times

Note: The capital employed in the division sold at 31 March 2014 was \$7 million (\$8 million sale proceeds less \$1 million profit on sale).

The figures for the calculations of 2014's adjusted ratios (i.e. excluding the effects of the sale of the division) are given in brackets; the figures for 2015 are derived from the equivalent figures in the question, however, the operating profit margin and ROCE calculations exclude the profit from the sale of the division (as stated in the requirement) as it is a 'one off' item.

(b) The most relevant comparison is the 2015 results (excluding the profit on disposal of the division) with the results of 2014 (excluding the results of the division), otherwise like is not being compared with like.

Profitability

Although comparative sales have increased (excluding the effect of the sale of the division) by \$4 million (36,000 – 32,000), equivalent to 12.5%, the gross profit margin has fallen considerably (from 37.5% in 2014 down to 33.3% in 2015) and this deterioration has been compounded by the sale of the division, which was the most profitable part of the business (which earned a gross profit margin of 44.4% (8/18)). The deterioration of the operating profit margin (from 18.8% in 2014 down to 10.3% in 2015) is largely due to poor gross profit margins, but operating expenses are proportionately higher (as a percentage of sales) in 2015 (23.0% compared to 18.8%) which has further reduced profitability. This is due to higher administrative expenses (as distribution costs have fallen), perhaps relating to the sale of the division.

Yogi's performance as measured by ROCE has deteriorated dramatically from 40.0% in 2014 (as adjusted) to only 21.8% in 2015. As the net asset turnover has remained broadly the same at 2.1 times (rounded), it is the fall in the operating profit which is responsible for the overall deterioration in performance. Whilst it is true that Yogi has sold the most profitable part of its business, this does not explain why the 2015 results have deteriorated so much (by definition the adjusted 2014 figures exclude the favourable results of the division). Consequently, Yogi's management need to investigate why profit margins have fallen in 2015; it may be that customers of the sold division also bought (more profitable) goods from Yogi's remaining business and they have taken their custom to the new owners of the division; or it may be related to external issues which are also being experienced by other companies such as an economic recession. A study of industry sector average ratios could reveal this.

Other issues

It is very questionable to have offered shareholders such a high dividend (half of the disposal proceeds) to persuade them to vote for the disposal. At \$4 million (4,000 + 3,000 – 3,000, i.e. the movement on retained earnings or 10 million shares at 40 cents) the dividend represents double the profit for the year of \$2 million (3,000 – 1,000) if the gain on the disposal is excluded. Another effect of the disposal is that Yogi appears to have used the other \$4 million (after paying the dividend) from the disposal proceeds to pay down half of the 10% loan notes. This has reduced finance costs and interest cover; interestingly, however, as the finance cost at 10% is much lower than the 2015 ROCE of 21.8%, it will have had a detrimental effect on overall profit available to shareholders.

Summary

In retrospect, it may have been unwise for Yogi to sell the most profitable part of its business at what appears to be a very low price. It has coincided with a remarkable deterioration in profitability (not solely due to the sale) and the proceeds of the disposal have not been used to replace capacity or improve long-term prospects. By returning a substantial proportion of the sale proceeds to shareholders, it represents a downsizing of the business.

3 (a) Clarion – Statement of profit or loss for the year ended 31 March 2015

	\$'000
Revenue	132,000
Cost of sales (w (i))	(106,550)
Gross profit	<u>25,450</u>
Distribution costs	(7,400)
Administrative expenses	(8,000)
Finance costs (w (ii))	(2,790)
Investment income (w (iii))	<u>1,000</u>
Profit before tax	8,260
Income tax expense (3,500 – 400 + 300 (w (iv)))	<u>(3,400)</u>
Profit for the year	<u>4,860</u>

(b) Clarion – Statement of changes in equity for the year ended 31 March 2015

	Share capital \$'000	Share premium \$'000	Retained earnings \$'000	Total equity \$'000
Balance at 1 April 2014	25,000	2,000	8,600	35,600
Rights issue (see below)	5,000	3,000		8,000
Dividends paid			(3,900)	(3,900)
Profit for the year			<u>4,860</u>	<u>4,860</u>
Balance at 31 March 2015	<u>30,000</u>	<u>5,000</u>	<u>9,560</u>	<u>44,560</u>

Prior to the 1 for 5 rights issue there were 25 million (30,000 x 5/6) shares in issue. Therefore the rights issue was 5 million shares at \$1.60 each (\$8 million), giving additional share capital of \$5 million and share premium of \$3 million (5 million x 60 cents).

(c) Clarion – Statement of financial position as at 31 March 2015

Assets	\$'000	\$'000
Non-current assets		
Property, plant and equipment (85,000 – 19,000 – 17,000)		49,000
Investments through profit or loss		6,500
Unamortised lease premium (1,000 – 250 (w (i)) – 250 current asset below)		<u>500</u>
		56,000
Current assets		
Inventory	11,700	
Trade receivables	18,500	
Lease premium prepayment	<u>250</u>	30,450
Total assets		<u>86,450</u>
Equity and liabilities		
Equity (see (b) above)		
Equity shares of \$1 each		30,000
Other equity component – share premium		5,000
Retained earnings		<u>9,560</u>
		44,560
Non-current liabilities		
8% loan notes	15,000	
Deferred tax (w (iv))	3,000	
Environmental provision (4,000 + 320 (w (ii)))	4,320	
Finance lease obligation (w (v))	<u>3,747</u>	26,067
Current liabilities		
Trade payables	9,400	
Finance lease obligation (4,770 – 3,747 (w (v)))	1,023	
Bank overdraft	1,900	
Current tax payable	<u>3,500</u>	15,823
Total equity and liabilities		<u>86,450</u>

(d) Clarion – Basic earnings per share for the year ended 31 March 2015

Profit per statement of profit or loss	\$4.86 million
Weighted average number of shares (w (vi))	28.3 million
Earnings per share	17.2 cents

(e) Clarion – Extracts from the statement of cash flows for the year ended 31 March 2015

	\$'000
Cash flows from investing activities	
Purchase of plant and equipment	(14,000)
Sale of investments	1,600
Cash flows from financing activities	
Issue of shares (see part (b))	8,000
Redemption of loan notes (w (vii))	(5,000)
Repayment of finance lease (2,300 + (1,500 – 570))	(3,230)
Equity dividends paid	(3,900)
Workings (figures in brackets in \$'000)	
(i)	\$'000
Cost of sales (per question)	88,300
Property rental (1,000 + (1,000/4 years) – see below)	1,250
Depreciation of plant and equipment (85,000 x 20%)	17,000
	<u>106,550</u>
The lease premium must be amortised, on a straight-line basis, over the length of the lease (four years).	
(ii) Finance costs	
8% loan notes (800 trial balance + 800 suspense account (w (vii)))	1,600
Finance lease (w (v))	570
Bank interest	300
Environmental provision (4,000 x 8%)	320
	<u>2,790</u>
(iii) Investment income	
Dividends received (500 – 200 profit on sale)	300
Profit on sale	200
Gains on fair value (6,500 – 6,000)	500
	<u>1,000</u>
(iv) Deferred tax	
Provision required as at 31 March 2015 (12,000 x 25%)	3,000
Balance at 1 April 2014	(2,700)
Charge to profit or loss	<u>300</u>
(v) Leased plant/finance lease obligation	
Fair value of plant/initial obligation (4,200 + 2,300 + 1,500)	8,000
Less deposit	<u>(2,300)</u>
	5,700
Interest at 10% to 31 March 2015	570
Less first annual payment	<u>(1,500)</u>
	4,770
Liability at 31 March 2015	4,770
Interest at 10% to 31 March 2016	477
Less second annual payment	<u>(1,500)</u>
	3,747
Liability at 31 March 2016	<u>3,747</u>

(vi) Theoretical ex-rights value

	Shares	\$	\$
Holding (say)	100	2.50	250
Rights take up (1 for 5)	<u>20</u>	1.60	<u>32</u>
	<u>120</u>		<u>282</u>
Theoretical ex-rights value		<u>2.35</u> (\$282/120)	
Weighted average number of shares:			
1 April 2014 to 30 September 2014	25 million x \$2.50/\$2.35 x 6/12 =		13.3 million
1 October 2014 to 31 March 2015	30 million x 6/12 =		<u>15.0 million</u>
Weighted average for year			<u>28.3 million</u>

(vii) Elimination of suspense account

		\$'000
Cash cost of loan note redemption (20,000 x 25%)		5,000
Six months' interest on loan note (20,000 x 8% x 6/12)		<u>800</u>
		<u>5,800</u>

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>
Section B		
1	(a) Goodwill at acquisition	6
	(b) (i) Revenue	1
	(ii) Cost of sales	3
	(iii) Finance costs	2½
	(iv) Profit or loss attributable to non-controlling interests.	2½
	Total for question	9
		15
2	(a) (i) and (ii) Gross profit margin	1
	Operating profit margin	1½
	Return on capital employed	1½
	Net asset turnover	1
		5
	(b) 1 mark per point (a good answer must consider the effect of the sale of the division)	10
	Total for question	15

		Marks
3	(a) Statement of profit or loss	
	revenue	1/2
	cost of sales	2
	distribution costs	1/2
	administrative expenses	1/2
	investment income	1 1/2
	finance costs	3
	income tax expense	2
		10
	(b) Statement of changes in equity	
	balances b/f	1
	rights issue	1
	equity dividends paid	1/2
	profit for the year	1/2
		3
	(c) Statement of financial position	
	property, plant and equipment	1
	investments through profit or loss	1
	unamortised lease premium	1
	inventory	1/2
	trade receivables	1/2
	8% loan notes	1
	deferred tax	1
	environmental provision	1
	non-current lease obligation	1/2
	trade payables	1/2
	current lease obligation	1
	bank overdraft	1/2
	current tax payable	1/2
		10
	(d) Basic earnings per share	
	earnings per statement of profit or loss	1/2
	theoretical ex-rights value	1
	calculation of weighted average number of shares	1 1/2
		3
	(e) Extracts from statement of cash flows	
	purchase of property, plant and equipment	1
	sale of investments	1/2
	issue of shares	1/2
	redemption of loan notes	1/2
	repayment of finance lease	1
	equity dividends paid	1/2
		4
	Total for question	30