Private & Confidential

FACULTY OF BUSINESS

FINAL EXAMINATION

Student ID (in Figures)	:	
Student ID (in Words)	:	

Course Code & Name	:	**ACC3113 FINANCIAL REPORTING 2**
Semester & Year	:	JANUARY – APRIL 2020
Lecturer/Examiner	:	JAMES LIOW
Duration	:	3 Hours

INSTRUCTIONS TO CANDIDATES

1. **This question paper consists of 2 parts:**
   PART A (50 marks) : Answer ONE (1) compulsory question. Answers are to be written in the Answer Booklet provided.
   PART B (50 marks) : Answer TWO (2) out of THREE (3) problem solving questions. Answers are to be written in the Answer Booklet provided.
2. **Candidates are not allowed to bring any unauthorized materials except writing equipment. Electronic dictionaries are strictly prohibited.**
3. **Only ballpoint pens are allowed to be used in answering the questions.**

WARNING: The University Examination Board (UEB) of BERJAYA University College regards cheating as a most serious offence and will not hesitate to mete out the appropriate punitive actions according to the severity of the offence committed, and in accordance with the clauses stipulated in the Students' Handbook, up to and including expulsion from BERJAYA University College.

Total Number of pages = 9 (Including the cover page)

PART A : **COMPULSORY QUESTION (50 MARKS)**

INSTRUCTION (S) : There is **ONE (1)** compulsory question in this section. Write your answers in the Answer Booklet(s) provided.

QUESTION 1

Section A

The following draft statements of financial position relate to Pearl Bhd and its subsidiary Sapphire Bhd, both public listed entities as at 31 December 2019:

	Note	Pearl Bhd RM'000	Sapphire Bhd RM'000
Assets			
Non-current assets			
Property, plant and equipment		1,435,000	915,000
Intangible assets		435,000	70,000
Equity investments	(i) & (iv)	2,250,000	500,000
		4,120,000	1,485,000
Current assets			
Inventory	(iii)	950,000	300,000
Accounts receivable	(iii)	240,000	155,000
Bank		200,000	56,000
		1,390,000	511,000
Total assets		**5,510,000**	**1,996,000**
Equity and liabilities			
Equity share capital		2,100,000	620,000
Retained earnings		2,080,000	707,000
Other components of equity		164,000	78,000
Total equity		4,344,000	1,405,000
Non-current liabilities		792,000	304,000
Current liabilities		374,000	287,000
Total liabilities		1,166,000	591,000
Total equity and liabilities		**5,510,000**	**1,996,000**

The following information is relevant to the preparation of the group financial statements:

(i) On 1 January 2016, Pearl Bhd acquired an 80% equity interest in Sapphire Bhd by a cash payment of RM206,400,000 and the balance by mean of an immediate share exchange of two shares in Pearl Bhd for five shares in Sapphire Bhd. The fair value of Pearl Bhd and Sapphire Bhd's shares on 1 January 2016 were RM4.00 and RM2.00 respectively. At this date the retained earnings and other components of equity were RM344 million and RM46 million respectively.

(ii) At the date of acquisition, the fair value of Sapphire Bhd's net assets was equal to their carrying amounts with the following exceptions:
- An item of unrecognised intangibles worth RM60 million and had an estimated remaining life of three years.
- An item of plant had a fair value of RM5 million above its carrying value. At the date of acquisition it had a remaining life of five years.
- It is group policy to measure non-controlling interests at the fair value at the date of acquisition. For this purpose Sapphire Bhd's share price at that date is representative of the fair value of the shares held by the non-controlling interest.

(iii) Goodwill has been reviewed annually, consolidated goodwill is to be written down by RM44 million as at 31 December 2019.

(iv) Pearl Bhd sells goods to Sapphire Bhd at cost plus 20%. Sapphire Bhd had RM500 million of goods in its inventory at 31 December 2019 which had been supplied by Pearl Bhd. In addition, on 28 December 2019, Pearl Bhd processed the sale of RM10 million of goods to Sapphire Bhd, which Sapphire Bhd did not account for until their receipt on 2 January 2020. The in-transit reconciliation should be achieved by assuming the transaction had been recorded in the books of Sapphire Bhd before the year end. At 31 December 2019, Pearl Bhd had a trade receivable balance of RM40 million due from Sapphire Bhd which differed to the equivalent balance in Sapphire Bhd's books due to the sale made on 28 December 2019.

(v) At 31 December 2019, the fair values of the equity investments Pearl Bhd and Sapphire Bhd were RM1,300 million and RM550 million respectively. As permitted by MFRS 9 *Financial Instruments,* any fair value gains and losses on all these equity investments through profit or loss.

Required:
Prepare the consolidated statement of financial position of the Pearl Bhd as at 31 December 2019.

(Section A: 30 marks)

Section B

Alpha Bhd (Alpha) has one subsidiary, Beta Bhd (Beta). The draft statements of profit or loss for both entities for the year ended 31 March 2020 are given below:

	Note	Alpha Bhd RM'000	Beta Bhd RM'000
Revenue	(iv)	400,000	280,000
Cost of sales	(ii) – (iii)	(240,000)	(170,000)
Gross profit		160,000	110,000
Distribution costs		(40,000)	(25,000)
Administrative expenses	(vi)	(50,000)	(29,000)
Investment income		45,000	-
Finance costs		(35,000)	(20,000)
Profit before tax		80,000	36,000
Income tax expense		(25,000)	(12,000)
Profit for the year		**55,000**	**24,000**

The following information is relevant to the preparation of the group financial statements:

Note: Alpha's investment in Beta

(i) On 1 April 2018, Alpha acquired 90 million of Beta's 120 million issued equity shares for a cash payment of RM327 million. On 1 April 2018, the directors of Alpha measured the non-controlling interest in Beta using Alpha's proportionate share of the net assets of Beta at that date.

(ii) On 1 April 2018, the net assets of Beta as shown in the individual financial statements of Beta totalled RM380 million. The directors of Alpha carried out a fair value exercise to measure the fair value of the identifiable assets and liabilities of Beta at 1 April 2018. The following matters emerged:

- Plant and equipment having a carrying amount of RM120 million had an estimated fair value of RM140 million. The estimated remaining useful life of this plant at 1 April 2018 was four years.
- A brand name relating to Beta had a fair value of RM30 million. This brand name was not recognised in the individual financial statements. The directors of Alpha considered that the useful life of this brand name was 10 years from 1 April 2018.
- A contingent liability relating to a pending legal case was disclosed in the notes to the financial statements of Beta at 1 April 2018. This contingent liability had a fair value of RM15 million at 1 April 2018. The contingency was settled during the year ended 31 March 2019.

(iii) All depreciation and amortisation of non-current assets is to be charged to cost of sales in the consolidated financial statements.

Note: Impairment review of goodwill on acquisition of Beta

(iv) On 31 March 2020, Alpha carried out an impairment review which identified that the goodwill on the acquisition of Beta was impaired by RM500,000. Impaired goodwill is charged to cost of sales.

Note: Intra-group trading

(v) Alpha provides Beta with a product which Beta uses as a raw material in its production process. Sales of the product by Alpha to Beta for the year ended 31 March 2020 totalled RM30 million. Alpha supplies this product to Beta at a mark-up of 20% on its cost of production.

(vi) On 31 March 2020, the inventories of Beta included RM6 million in respect of raw materials supplied by Alpha. On 31 March 2019, the amount in the inventories of Beta was RM4.8 million.

Note: Research and development project

(vii) On 1 April 2019, Alpha began a research project. The aim of the project was to investigate ways of streamlining its production process. The initial costs of setting up the project were RM5 million. From 1 April 2019 to 30 June 2019 ongoing project costs were RM500,000 per month. On 1 July 2019, the project was considered to be technically feasible and commercially viable and from this date project costs increased to RM600,000 per month. The project was completed on 31 December 2019 and the new production process began to be used from 1 January 2020. The new process is likely to produce economic benefits for Alpha for five years from 1 January 2020. Alpha charged all the costs to complete the project to administrative expenses.

(viii) Amortisation of the development costs is to be charged to cost of sales in the consolidated financial statements when it is capitalised from the administrative expenses which is incorrectly charged to profit or loss.

Required:

a) Calculate the consolidated goodwill as at 31 March 2020. (4 marks)

b) Prepare the consolidated statement of profit or loss and other comprehensive income of Alpha Bhd for the year ended 31 March 2020. (16 marks)

(Section B: 20 marks)

[Total 50 marks]

END OF PART A

PART B : **PROBLEM SOLVING QUESTIONS (50 MARKS)**

INSTRUCTION (S) : There are **THREE (3)** questions in this section, answer only **TWO (2)** questions. Write your answers in the Answer Booklet(s) provided.

QUESTION 1

Kappa Medic Bhd (Kappa) prepares financial statements to 30 September each year. On 1 October 2018, Kappa has sourced a PET and CT scanner equipment to be used for scanning cancer patients. Kappa acquired this new scanner equipment from Lisbon Finance Bhd and entered into a lease contract to lease the equipment on a 5-year lease.

The annual lease payments were RM500,000 payable in arrears and the first payment being made on 30 September 2019 and subsequently the same for the following respective years. Kappa incurred the following costs in the course of arranging the lease equipment:

Cost	RM
Legal fees of executing the lease	45,500
Commissioning the equipment	14,500
Cost of negotiating the terms and conditions	5,200

The board of directors of Kappa has unanimously agreed to exercise the purchase option at the end of the lease term. The equipment has an economic useful life of 10 years with no residual value.

Assumptions:

(i) Taxation implications are to be ignored.

(ii) The present value factor for an ordinary annuity for RM1.00 at the interest rate of 10% is 3.7908.

Required

a) List any **THREE** (3) definitions or series of test, at the inception of the contract to assess whether the assets are in accordance to Paragraph 9 of MFRS 16 *Leases*. (6 marks)

b) Under the MFRS 16 *Leases*, there is only one lease accounting model for all leases. List **THREE** (3) exemptions if the entity is not applying the requirements of MFRS 16 and indicate the accounting treatments if the exemptions apply. (4 marks)

c) Calculate the initial amount to be recognised as right of use asset in the statement of financial position at the beginning of the lease term. (4 marks)

d) Prepare a lease liability schedule showing how the finance charges, liability at the beginning and the start of the period would be allocated to each of the 5 years. (5 marks)

e) Show an extract of the statement of financial position for 4 years period in respect of the lease in the books of Kappa Medic Bhd.
   i) Non-current assets at carrying amount
   ii) Non-current liabilities
   iii) Current liabilities (6 marks)

[Total 25 marks]

QUESTION 2

The following four cases are to be treated separately:

<u>Case 1</u>

Canto Bhd (Canto) is a company which manufactures industrial machinery and has a year end of 28 February 2020. The directors of Canto require advice on the following issues:

On 1 March 2017, Canto acquired a property for RM15 million, which was used as an office building. Canto measured the property on the cost basis in property, plant and equipment. The useful life of the building was estimated at 30 years from 1 March 2017 with no residual value. Depreciation is charged on the straight-line basis over its useful life. At acquisition, the value of the land content of the property was thought to be immaterial.

During the financial year to 28 February 2020, the planning authorities approved the land to build industrial units and retail outlets on the site. During 2020, Canto ceased using the property as an office and converted the property to an industrial unit. Canto also built retail units on the land during the year to 28 February 2020. At 28 February 2020, Canto wishes to transfer the property at fair value to investment property at RM20 million. This valuation was based upon other similar properties owned by Canto. However, if the whole site were sold including the retail outlets, it is estimated that the value of the industrial units would be RM25 million because of synergies and complementary cash flows.

Required

a) If the management of Canto has agreed to adopt the cost model for the reclassification of property, calculate the carrying amount for the financial year ended 2020. (2 marks)

b) If the management has adopted the fair value model of reclassification, discuss how these transactions are be accounted for under the scope of MFRS 40 *Investment Property* by journalising the entries for the financial year ended 2020. (4 marks)

Case 2

An entity may also provide ancillary services to the occupants of its property such as security, cleaning and maintenance services to the tenants who occupy the building.

Required

c) Discuss how the accounting treatments would be applied for services which are significant and insignificant to the arrangement as a whole. (3 marks)

d) If the ancillary services are unable to determine whether is significant or not, discuss whether the property which fall under the scope of MFRS 140 *Investment Property* or MFRS 116 *Property, Plant and Equipment*. (3 marks)

Case 3

An entity (parent) owns a building that it rents out to its subsidiary under an operating lease in return for rental payment. The subsidiary uses the building as a retail outlet for its products.

Required

e) Discuss how the property is accounted for in the book of subsidiary and its consolidated group account by reference to the relevant accounting standards. (3 marks)

Case 4

The accountant of East West Plantation Bhd reports the following activities which include grows rubber trees and oil palm trees. Eagle Point exports its produce, latex and palm oil to Thailand, Singapore and China.

Required

f) Explain the accounting treatments of the activities reported by East West Plantation Bhd by reference to the relevant accounting standards. (6 marks)

g) Explain how the agriculture produce, i.e. latex and palm oil are measured under MFRS 141.

(4 marks)

[Total 25 marks]

QUESTION 3

Epsilon Bhd prepares financial statements to 31 March each year. The following events have occurred which are relevant to the year ended 31 March 2020:

(i) On 1 April 2019, Epsilon Bhd loaned RM30 million to another entity. Interest of RM1.5 million is payable annually in arrears. An additional final payment of RM35.3 million is due on 31 March 2022. Epsilon Bhd incurred direct costs of RM250,000 in arranging this loan. The annual rate of interest implicit in this arrangement is approximately 10%. Epsilon Bhd has no intention of assigning this loan to a third party at any time. (9 marks)

(ii) On 1 April 2019, Epsilon Bhd purchased 500,000 shares in a key supplier – entity X. The shares were purchased in order to protect Epsilon Bhd's source of supply and Epsilon Bhd has no intention of trading in these shares. The shares cost RM2.00 per share and the direct costs of purchasing the shares were RM100,000. On 1 January 2020, the supplier paid a dividend of 30 sen per share. On 31 March 2020, the fair value of a share in entity X was RM2.25. (9 marks)

(iii) On 1 January 2020, Epsilon Bhd purchased 100,000 call options to purchase shares in entity Y – an unconnected third party. Each option allowed Epsilon Bhd to purchase shares in entity Y on 31 December 2020 for RM6.00 per share. Epsilon Bhd paid RM1.25 per option on 1 January 2020. On 31 March 2020, the fair value of a share option purchased by Epsilon Bhd was RM1.60. This purchase of call options is not part of a hedging arrangement. (7 marks)

Required

In each of the above three events:

- Indicate the business model used.
- Prepare the journal entries to record the transactions in the financial statements of Epsilon Bhd for the year ended 31 March 2020. (The journal entries must include the initial measurement and amount to be charged to profit or loss or to other comprehensive income).
- Calculate the carrying amount of the financial assets as at 31 March 2020.

[Total 25 marks]

END OF QUESTION PAPER