INTERNATIONAL STANDARDS INTERNATIONAL STANDARDS INTERNATIONAL STANDARDS INTERNATIONAL

CIMA

Intermediate Level

Financial Reporting – International Accounting Standards

7b IFRI

19 November 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 with the printed question paper but are available elsewhere on the website.
Write your examination number, your contact ID and your name on a double-sided card, which must be attached to your 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 included with this question paper booklet. Detach the sheet from the booklet and insert it in your answer book before you hand this in.
Do NOT write your name or your contact ID anywhere on this booklet.
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 Parent owns 80% of the equity share capital of Child, its only subsidiary. The following information is extracted from the individual balance sheets of the two companies on 30 September 2003:

	Parent	*Child*
	$	*$*
Current assets	600,000	450,000
Current liabilities	350,000	300,000

The current liabilities of Child include $80,000 in respect of a dividend that was declared before 30 September 2003 and paid on 31 October 2003. Parent recognises investment income on a cash basis.

If there are no other intra-group balances, what is the value of the consolidated net current assets (current assets less current liabilities) of Parent at 30 September 2003.

A $320,000

B $400,000

C $464,000

D $480,000

Financial Reporting – International Standards

NOVEMBER 2003 EXAMINATION

SPECIAL ANSWER SHEET FOR SECTION A

Write here your full examination number:				
Centre Code				
Hall Code				
Desk Number				

1.1	**A**	**B**	**C**	**D**
1.2	**A**	**B**	**C**	**D**
1.3	**A**	**B**	**C**	**D**
1.4	**A**	**B**	**C**	**D**
1.5	**A**	**B**	**C**	**D**
1.6	**A**	**B**	**C**	**D**
1.7	**A**	**B**	**C**	**D**
1.8	**A**	**B**	**C**	**D**
1.9	**A**	**B**	**C**	**D**
1.10	**A**	**B**	**C**	**D**

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 in to the invigilators at the end of the examination.

1.2 Foot owns 150,000 of the issued ordinary shares and 60,000 of the issued preferred shares of Step (its only subsidiary). The balance sheets of the two enterprises at 31 August 2003 showed the following:

	Foot	*Step*
	$000	*$000*
Ordinary shares of $1	500	250
Preferred shares of $1	100	150
Accumulated profits	250	170
	850	570

What is the minority interest that will appear in the consolidated balance sheet of Foot at 31 August 2003?

A $228,000

B $258,000

C $292,000

D $342,000

1.3 On 30 June 2003, Sugar entered into an agreement with two other investors to establish a new enterprise, Spice. All three investors subscribed for $^1/_3$ of the equity shares in Spice and each share carries one vote. All three investors appointed two representatives to the six-member board of directors of Spice. All key policy decisions require the agreement of five of the six board members.

The following statements refer to the treatment of the investment in Spice in the consolidated financial statements of Sugar for the year ended 30 September 2003:

(i) Spice will be treated as a joint venture simply because the three investors hold $^1/_3$ of the shares each.

(ii) Spice will be treated as a joint venture in this case, but only because of the requirement that key policy decisions require the consent of at least five of the directors.

(iii) If Spice carries on a business that is distinct from that of its investors, then it will be consolidated using proportional consolidation.

(iv) Spice is only a joint venture if the requirement that key policy decisions require the consent of five directors is established by contract.

Assuming the benchmark treatment set out in IAS 31 – *Financial Reporting of Interests in Joint Ventures* – is used, which of the above statements are true?

A (i) and (iii) only.

B (i), (iii) and (iv) only.

C (ii) and (iii) only.

D (ii), (iii) and (iv) only.

1.4 On 1 July 1994, Super acquired 75% of the ordinary shares in Man for $6 million. Goodwill on consolidation of $1 million was amortised on a monthly basis over 20 years or 240 months).

On 31 December 2002 (102 months after acquisition), Super disposed of part of its shareholding in Man for $4 million, retaining a 40% interest. The net assets of Man on 1 July 2002 were $8·5 million and Man made a profit of $800,000 in the year ended 30 June 2003 (no dividends were paid or declared by Man in that year).

What is the profit on disposal that will be included in the consolidated income statement of Super for the year ended 30 June 2003?

A $616,667

B $683,750

C $885,000

D $1,200,000

1.5 Near has a subsidiary, Faraway, that prepares its financial statements in florins. Near owns 80% of the ordinary shares of Faraway.

On 1 October 2002, the net assets of Faraway that were included in the consolidated balance sheet of Near had a carrying value of 40 million florins. The profit of Faraway for the year ended 30 September 2003 was 4·5 million florins. Near translates the financial statements of Faraway for consolidation purposes using the closing rate method.

Relevant exchange rates are as follows:

Date	*Exchange rate [florins to $1]*
1 October 2002	2·5
30 September 2003	2·0
Average for the year ended 30 September 2003	2·25

Ignoring goodwill on consolidation, what is the exchange gain relating to Faraway that will be taken to the consolidated statement of changes in equity of Near for the year ended 30 September 2003?

A $3,200,000

B $3,400,000

C $4,000,000

D $4,250,000

1.6 A cash-generating unit was reviewed for impairment at 31 May 2003 as required by IAS 36 – *Impairment of assets*. The impairment review revealed that the cash-generating unit had a value in use of $25 million and a net realisable value of $23 million.

The carrying values of the net assets of the cash-generating unit immediately prior to the impairment review were as follows:

	$000
Goodwill	5,000
Property, plant and equipment	18,000
Net current assets	4,000
	27,000

The review indicated that an item of plant (included in the above figure of $18 million) with a carrying value of $1 million had been severely damaged and was virtually worthless. There was no other evidence of obvious impairment to specific assets.

What is the carrying value of the goodwill relating to the unit immediately after the results of the impairment review have been reflected in accordance with IAS 36?

A $1 million

B $2 million

C $3 million

D $4 million

1.7 Spencer has produced draft consolidated financial statements for the year ended 30 June 2003. These financial statements include a deferred tax liability of $8 million. However, no account has been taken of the potential deferred tax implications of the following:

(i) On 30 June 2003, the group revalued all its properties and a surplus of $7 million was taken to the statement of changes in equity. The group has no intention of disposing of any of these properties in the foreseeable future.

(ii) One of the subsidiaries of Spencer made a loss adjusted for tax purposes of $2 million in the year ended 30 June 2003. This loss can only be relieved against future trading profits made by the subsidiary. The directors of Spencer believe the loss made by the subsidiary to be attributable to non-recurring factors.

What is the deferred tax liability of Spencer at 30 June 2003 under the provisions of IAS 12 – *Income Taxes* after taking account of both the above events? [Use a rate of tax of 30% where required.]

A $7·4 million

B $8 million

C $9·5 million

D $10·1 million

1.8 B issued new interest-bearing borrowings to finance a construction project on the following terms:

- The new borrowings had a nominal value of $50 million.
- The borrowings carried an annual interest rate of 4%.
- The costs of issuing the borrowings totalled $600,000. This comprised underwriting fees relating to the issue of $500,000 and fees of $100,000 payable for general advice on which of a number of sources of finance should be pursued.
- The borrowings were theoretically repayable at $60 million after five years. However, the borrowings contained an option to convert into ordinary shares after five years as an alternative to repayment. At the date of issue, the directors of B were virtually certain that the investors would choose the conversion option.

What is the total financing cost relating to these borrowings?

A $10·5 million

B $10·6 million

C $20·5 million

D $20·6 million

1.9 The following statements relate to accounting for retirement benefits under the provisions of IAS 19 – *Employee benefits.* [The "net pension asset" is the fair value of plan assets less the present value of plan liabilities.]

(i) Other things being equal, the net pension asset increases when interest rates increase.

(ii) Other things being equal, the net pension asset decreases when share prices fall.

(iii) Where the terms of retirement benefits are altered so as to provide immediate additional benefits to retired members, then the cost of the additional benefits should be recognised in the income statement over a period equal to the average life expectancy of the retired members.

Which of the statements are true?

A (i) and (ii) only.

B (i) and (iii) only.

C (ii) and (iii) only.

D All of them.

1.10 Experimenter appraises projects using a cost of capital of 12%. All non-current assets of Experimenter are depreciated on a straight-line basis over their useful economic lives.

On 1 July 2002, Experimenter opened a chemical reprocessing plant. The plant was due to be active for five years until 30 June 2007, when it would be decommissioned. At 1 July 2002, the costs of decommissioning the plant were estimated to be $4 million.

What is the total charge to the income statement in respect of the decommissioning for the year ended 30 June 2003?

A $453,600

B $725,760

C $800,000

D $2,268,000

(Total = 20 marks)

End of section A

SECTION B – 30 MARKS

ANSWER THIS QUESTION [THE REQUIREMENT IS ON PAGE 13]

Question Two

The balance sheets of George and its subsidiary enterprises Zippy and Bungle at 30 June 2003 (the accounting date for all three enterprises) are given below:

	George		*Zippy*		*Bungle*	
	$000	*$000*	*$000*	*$000*	*$000*	*$000*
ASSETS						
Non-current assets:						
Property, plant and equipment (*Note 3*)	45,000		25,000		20,000	
Financial assets (*Notes 1* and *2*)	20,000		Nil		Nil	
		65,000		25,000		20,000
Current assets:						
Inventories (*Notes 3* and *4*)	18,000		12,000		11,000	
Trade and other receivables (*Notes 3* and *4*)	15,000		10,000		9,000	
		33,000		22,000		20,000
Total assets		98,000		47,000		40,000
EQUITY AND LIABILITIES						
Capital and reserves:						
Issued ordinary share capital ($1 shares)	25,000		15,000		10,000	
10% $1 preferred shares	Nil		10,000		Nil	
Share premium account	10,000		Nil		4,000	
Accumulated profits	24,000		8,000		9,300	
		59,000		33,000		23,300
Non-current liabilities						
Interest bearing borrowing (*Note 3*)	20,000		Nil		4,000	
Deferred tax (*Note 3*)	2,000		1,000		1,500	
		22,000		1,000		5,500
Current liabilities						
Trade payables (*Note 4*)	10,000		6,500		6,000	
Tax payable	2,000		1,500		1,000	
Proposed dividend (*Note 5*)	Nil		1,000		Nil	
Bank overdraft	5,000		4,000		3,000	
Provisions (*Note 3*)	Nil		Nil		1,200	
		17,000		13,000		11,200
Total equity and liabilities		98,000		47,000		40,000

Notes to the balance sheets

1 On 1 July 1990, the date of incorporation of Zippy, George subscribed for all the ordinary shares of Zippy at par. Then, on 1 July 1995, when its balance of accumulated profits was $3 million, Zippy issued 10 million $1 preferred shares at par. George subscribed for 50% of these shares.

2 On 30 June 2003, George purchased 8 million $1 shares in Bungle. The terms of the purchase consideration were as follows:

2.1 On 30 June 2003, George issued 3 $1 ordinary shares for every 4 shares purchased in Bungle. The market value of the ordinary shares at 30 June 2003 was $4 per share.

2.2 On 30 June 2005, George will pay the former shareholders of Bungle $1 in cash for every share in Bungle they have purchased. This payment is contingent on the cumulative profits after tax of Bungle for the two years ending 30 June 2005 being at least $3 million.

At the date of carrying out the fair value exercise (see *Note 3* below), the directors of George considered it probable that this cash payment would be made.

2.3 No entries in respect of the purchase of shares in Bungle have been made in the balance sheet of George.

3. Following the acquisition of Bungle, the directors of George carried out a fair value exercise as required by IAS 22 – *Business combinations*. The following matters are relevant and all potential fair value adjustments are material:

3.1 Property, plant and equipment comprise land and buildings and plant and machinery. At 30 June 2003, the land and buildings had a carrying value of $12 million and a market value of $18 million. The plant and machinery had a carrying value of $8 million. All the plant and machinery was purchased on 30 June 2000 and was being depreciated on a straight-line basis over 8 years. No reliable estimate was available of the current market value of the plant and machinery, but at 30 June 2003, the plant would have cost $22 million to replace with new plant.

3.2 The inventory at 30 June 2003 comprised:

- Finished goods which could be sold for $14·5 million. A reasonable profit allowance for the selling effort of the group would be $3 million.
- Finished goods that had been damaged and could only be sold for $100,000, representing a significant loss on sale.

3.3 Trade receivables includes an amount of $400,000 that the directors of George consider doubtful.

3.4 The interest-bearing borrowing of Bungle is repayable at par on 30 June 2006. Interest at 10% per annum is payable annually in arrears and the payment due on 30 June 2003 has already been made. The relevant discount rate is 7%.

3.5 The other provisions of Bungle comprise:

- $400,000 in respect of the closure of various retail outlets to which the directors of Bungle became committed prior to entering into acquisition negotiations with the directors of George.
- $800,000 in respect of the estimated cost of integrating Bungle into the George group. No detailed integration plans had been formulated by 30 June 2003.

3.6 The additional deferred tax that needs to be provided on the adjustments that are necessary as a result of the fair value exercise is a liability of $3 million.

4 George supplies a component to Zippy at cost plus a mark up of 20%. At 30 June 2003, the inventories of Zippy included $1·5 million in respect of this component. At 30 June 2003, the receivables of George showed an amount receivable from Zippy of $1·2 million, while the trade payables of Zippy showed an amount payable to George of $600,000. On 29 June 2003, George sent a consignment of components to Zippy at an invoiced price of $600,000. The consignment was received and recorded by Zippy on 2 July 2003.

5 On 15 July 2003, Zippy paid its preferred share dividend for the year ended 30 June 2003. George made no entries in its financial statements in respect of this dividend until it was received in cash.

6 Goodwill on consolidation is amortised over its estimated useful economic life of 20 years. The amortisation of goodwill on consolidation of Bungle commences on 1 July 2003.

6.1 In preparing its consolidated financial statements, George measures the assets and liabilities of subsidiaries using the allowed alternative treatment laid down in IAS 22.

Required:

(a) Compute the goodwill on consolidation of Bungle that will be shown in the consolidated balance sheet of George at 30 June 2003. Provide justification for your figures where you consider this is needed.

(14 marks)

(b) Prepare the consolidated balance sheet of George at 30 June 2003.

(16 marks)

(Total = 30 marks)

End of section B

SECTION C – 50 MARKS

ANSWER TWO QUESTIONS ONLY

Question Three

You are the accountant of Acquirer. Your enterprise has the strategy of growth by acquisition and your directors have identified an enterprise, Target, which they wish to investigate with a view to launching a takeover bid. Your directors consider that the directors of Target will contest any bid and will not be very co-operative in providing background information on the enterprise. Therefore, relevant financial information is likely to be restricted to the publicly available financial statements.

Your directors have asked you to compute key financial ratios from the latest financial statements of Target [for the year ended 30 November 2002] and compare the ratios with those for other enterprises in a similar sector. Accordingly, you have selected ten broadly similar enterprises and have presented the directors with the following calculations:

Ratio	*Basis of calculation*	*Ratio for Target*	*Spread of ratios for comparative enterprises*		
			Highest	*Average*	*Lowest*
Gross profit margin	$\frac{\text{Gross profit}}{\text{Revenue}}$	42%	44%	38%	33%
Operating profit margin	$\frac{\text{Profit from operations}}{\text{Revenue}}$	29%	37%	30%	26%
Return on total capital	$\frac{\text{Profit from operations}}{\text{Total capital}}$	73%	92·5%	69%	52%
Interest cover	$\frac{\text{Profit from operations}}{\text{Finance cost}}$	1·8 times	3·2 times	2·5 times	1·6 times
Gearing	$\frac{\text{Debt capital}}{\text{Total capital}}$	52%	56%	40%	28%
Dividend cover	$\frac{\text{Profit after tax}}{\text{Dividend}}$	5·2 times	5 times	4 times	3 times
Turnover of inventory	$\frac{\text{Cost of sales}}{\text{Closing inventory}}$	4·4 times	4·5 times	4 times	3·2 times
Receivables days	$\frac{\text{Trade receivables}}{\text{1 day's sales revenue}}$	51 days	81 days	62 days	49 days

Required:

(a) Using the ratios provided, write a report that compares the financial performance and position of Target to the other enterprises in the survey. Where an issue arises that reflects particularly favourably or unfavourably on Target, you should assess its relevance to a potential acquirer.

(16 marks)

(b) Identify any reservations you have regarding the extent to which the ratios provided can contribute to an acquisition decision by the directors of Acquirer. You should highlight the extent to which the financial statements themselves might help you to overcome the reservations you have identified.

(9 marks)
(Total = 25 marks)

Question Four

You are the chief accountant of Ant, an enterprise that prepares financial statements in accordance with International Accounting Standards. Your assistant has prepared the first draft of the consolidated financial statements for the year ended 31 October 2003 and these show a profit after tax of $66 million, while the balance sheet shows ownership interests [total assets less total liabilities, including minority interests] of $450 million.

Your assistant has identified the following issues that require your review:

Issue (a)
An overseas subsidiary has made a loss (adjusted for tax purposes and appropriately translated into $s) of $15 million for the year ended 31 October 2003. Local tax legislation allows this loss to be relieved for tax purposes only against future profits of the same trade. Ant has no other subsidiaries in the same tax jurisdiction as this subsidiary. The loss is primarily due to a reduction in turnover caused by a reduction in demand for the product that the subsidiary produces. There is little indication that demand will be restored to its former levels in the foreseeable future.

Your assistant has recognised a deferred tax asset of $6 million in the draft financial statements, being the future tax consequences of the timing difference of $15 million, measured at the local tax rate of 40%. This deferred tax asset has been offset against deferred tax liabilities arising on timing differences originating in other tax jurisdictions.

Issue (b)
On 1 November 2002, Ant established a new subsidiary located in a jurisdiction where the unit of currency is the Franco. The initial investment was 40 million Francos (the initial net assets of the subsidiary). The investment was financed by a loan of 40 million Francos from a German bank. No capital repayments of the loan are due until 31 October 2022.

The exchange rate at 1 November 2002 was 1·6 Francos to $1. On 31 October 2003, the exchange rate was 1·5 Francos to $1. Due to large start-up costs, the subsidiary did not make a profit in the early months of trading and the net assets of the subsidiary at 31 October 2003 remained at 40 million Francos.

In preparing the draft consolidated financial statements, your assistant has translated both the loan and the financial statements of the subsidiary at 1·6 Francos to $1 on the basis that the financing of the subsidiary was obtained when the exchange rate was 1·6 Francos to $1. The subsidiary has its own distinct market presence and manufactures its products locally.

Issue (c)
On 1 November 2002, Ant issued two million $100 loan notes at $90 per note. A merchant bank received $4 million to underwrite the issue and Ant incurred other costs of $500,000 relating to the issue of the notes. The notes pay no interest and are redeemable at $135 per note on 31 October 2007. As an alternative to redemption, the notes can be converted into 50 equity shares per $100 note on 31 October 2007.

Your assistant has written off the issue costs of $4·5 million to the income statement for the year ended 31 October 2003 as an administrative expense and credited the proceeds of issue [$180 million] to a convertible loan notes account. He proposes to show this in the capital and reserves section of the balance sheet on the basis that the share price on 31 October 2007 is likely to be at least $4, so conversion, rather than repayment, is likely to be a near certainty.

Your assistant has been informed that, at 1 November 2002, the fair value of the options to convert the loan notes into shares on 31 October 2007 was $22·5 million. However, he does not consider this information to be relevant and so has ignored it.

Required:

For each of the three issues, evaluate the treatment adopted by your assistant with reference to currently published Accounting Standards. Where you consider the treatment adopted to be incorrect, you should state the journal adjustment required to correct the error.

In all cases, you should give any supporting explanations you consider appropriate to justify your conclusions.

The allocation of marks to the three issues is as follows:

Issue (a)	*(6 marks)*
Issue (b)	*(9 marks)*
Issue (c)	*(10 marks)*

(Total = 25 marks)

Question Five

You are the accountant responsible for training at Develop, an enterprise with a number of investments throughout the world. A key financial reporting task is to prepare consolidated financial statements and this forms an important aspect of the training of new accountants.

A recently-employed trainee has sent you this memorandum:

> I have just attended my first training course and have learned the mechanics of how to treat subsidiaries, associates, and trade investments in the consolidated accounts. I'm reasonably comfortable with the numbers but the concepts baffle me. Why does the exercise of adding together the balance sheets of our enterprise with those of our subsidiaries give our shareholders useful financial information? Why do we treat associates differently – I find the concept of adding together all the net assets and showing our share as one amount particularly confusing? I'm happier with the treatment of trade investments, at least I can see that the figure is what we paid to buy the shares. Why not do this for all our investments? I don't need a detailed explanation of the mechanics, which I'm already reasonably happy with.

Required:

(a) Draft a reply to your trainee that explains the principles underpinning the preparation of consolidated financial statements. You should clearly explain why subsidiaries, associates and trade investments are treated differently and why the information is of benefit to the shareholders of the investor.

(15 marks)

You also receive a memorandum from a slightly more experienced trainee:

> I've just attended my second training course and a couple of things confused me. First of all we were told that the net assets of newly-acquired subsidiaries need to be revalued to fair value at the date of acquisition. I don't see how this can produce sensible results unless the net assets of other group members are revalued at the same time. Then we were told about another method of consolidation, the uniting of interests method. This seemed a lot easier than the normal one. It seems that we don't need to worry about fair value adjustments under this method and we don't even have to distinguish between pre- and post-acquisition profits. What's more, it seems to produce higher reported profits! Why don't we use it all the time?

Required:

(b) Draft a reply to this second trainee that explains the rationale behind fair value adjustments and identifies the type of business combinations which might lead to the use of the uniting of interests method of consolidation. You do NOT need to explain the detailed mechanics of fair value adjustments or the uniting of interests method. However, you should refer to any relevant current developments.

(10 marks)

(Total = 25 marks)

Question Six

Global is an enterprise preparing financial statements in accordance with International Accounting Standards. Global has a subsidiary, Local, located in a jurisdiction that prepares financial statements in $ dollars in a format that is consistent with IAS 1 – *Presentation of Financial Statements* – but otherwise in accordance with local accounting standards

The financial statements of Local for the year ended 30 September 2003 [the group accounting date] are given below:

Income statement – year ended 30 September 2003:

	$000
Revenue	40,000
Cost of sales	(25,000)
Gross profit	15,000
Other operating expenses	(10,000)
Profit from operations	5,000
Profit on sale of land	2,000
Finance cost	(1,500)
Profit before tax	5,500
Income tax expense	(500)
Profit for the period	5,000

Balance sheet at 30 September 2003

	$000	*$000*
ASSETS		
Non-current assets:		
Property, plant and equipment	21,000	
Intangible assets	3,000	
		24,000
Current assets		7,000
		31,000
EQUITY AND LIABILITIES		
Capital and reserves:		
Issued capital	8,000	
Revaluation reserve	2,000	
Accumulated profits	8,000	
		18,000
Non-current liabilities		
Interest-bearing borrowings	9,000	
Deferred tax	1,000	
		10,000
Current liabilities		3,000
		31,000

The accountant of Local has informed you of the following transactions that have occurred during the year.

1 The directors of Local decided to make the balance sheet stronger by including their estimate of the value of key employees as an intangible non-current asset. They placed a value of $3 million on the asset and justified its inclusion on the basis that the expertise of key employees gave Local a clear competitive edge. No amortisation was charged on the basis that the asset was unlikely to lose value. The asset was incorporated into the financial statements by debiting non-current assets and crediting other operating expenses.

2 On 1 October 2002, Local sold a piece of land for $16 million, at a time when the carrying value of the land was $14 million and its market value $20 million. In preparing the financial statements for the year to 30 September 2003, Local recognised the revenue from the sale and eliminated the cost of the land, disclosing the profit on sale of $2 million separately in the income statement.

At the time of the sale, Local was given an option to repurchase the land on 30 September 2003, 2004 or 2005 on the following terms:

- 30 September 2003 $17·6 million
- 30 September 2004 $19·36 million
- 30 September 2005 $21·296 million

The option was not exercised on 30 September 2003 and is unlikely to be exercised on 30 September 2004 due to anticipated cash shortages in that year. However, the cash shortages are expected to be temporary and Local expects substantial accumulations of cash in 2005. The directors of Local expect the price of land to rise at around 12% per annum for the foreseeable future.

3 Local has a policy of periodically revaluing all its properties. All properties were revalued in the current period. One of the properties that was revalued during the year was a factory that had a carrying value prior to revaluation of $8 million. The current value of the property was estimated at $7 million. The deficit was caused by the fact that the product manufactured in the factory was no longer popular with customers. The deficit has been offset against the revaluation reserve on the basis that, although the factory had not previously been revalued, there was a balance of more than $1 million in the revaluation reserve relating to previous revaluations of other properties. Properties and land are regarded as separate classes of property, plant and equipment and land is not subject to periodic revaluations.

In other respects, the accounting practices followed by Local are in accordance with International Accounting Standards.

Required:

(a) Redraft the income statement and balance sheet of Local to reflect any adjustments that are necessary to ensure that they are prepared in accordance with International Accounting Standards. You should fully explain any adjustments you make by referring to necessary International Accounting Standards or frameworks.

Ignore any potential adjustments to deferred tax.

(20 marks)

(b) Discuss the suggestion that it would be easier for consolidation purposes if all group enterprises followed International Accounting Standards when preparing their individual financial statements.

(5 marks)

(Total = 25 marks)

End of paper