QUESTION TWO – Answers to this question must be presented in the spaces after each part (60 POINTS)

A: FINANCIAL INSTRUMENTS (15 Marks)

(i) On 1 January 2021, a company buys £50,000 of 7% loan stock for £47,865. Interest is received on 31 December each year and the stock will be redeemed at a premium of 10% on 31 December 2024. The effective interest rate is 10.5% per annum. Calculate the amortised cost of the loan stock at 31 December 2021. (**5 Marks**)

Space Workings:

The loan stock is initially recognised at £47,865. Adding on interest at 10.5 %*£47,865 (£5,026) and subtracting the amount received £50,000*7% (ie £3,500) leaves a balance at the end of 2021 of **£49,391.**

The loan stock is initially recognised = £47,865
Add: interest earned (10.5 %*£47,865) = £5,026
Less: Amount received (£50,000*7%) = -£3,500
£49,391

(ii) A company issues £500,000 of 6.5% loan stock at a discount of 8%. Issue costs of £25,000 are incurred. The loan stock should be measured initially at: (**5 Marks**)

Space Workings:

The company receives £460,000 from the lenders and spends £25,000 of this on issue costs. Therefore the loan stock should be measured initially at **£435,000**

(iii) On 1 May 2015, a company issues £400,000 of 6% convertible loan stock at par. Interest is payable on 30 April each year. The stock is due for redemption at par on 30 April 2018 but may be converted into ordinary shares on that date instead.
If the company had issued the loan stock without the conversion option, it would have had to pay interest at 8% rather than 6%.
The equity component of this loan stock is: (**5 Marks**)

Space Workings:
The company will pay interest of £24,000 (ie £400,000* 6%) on 30 April 2016, 2017 and 2018. The £400,000 will be also repaid on 30 April 2018. Using a discounting rate of 8%, the present value of these cash flows is:

30 April 2016 (£24,000 ÷1.08) = £22,222
30 April 2017 (£24,000 ÷1.082) = £20,576
30 April 2018 (£424,000 ÷1.083) = £336,585

Nominal value		400,000	
coupon rate with conversion		6%	
coupon rate without conversion		8%	
Year	**Expected cash flow(£)**	**Discount Factor (8%)**	**PV(£)**
30 April, 2016 (400,000*6%)	24,000	0.92593	22,222
30 April, 2017 (400,000*6%)	24,000	0.85734	20,576
30 April, 2018(400,000*6%+400,000)	424,000	0.79383	336,585
		NPV	**379,383**

The total of these cash flows is £379,383 and this is the liability component
The equity component is therefore **£20,617** (ie £400,000 – £379,383).

B: GOVERNMENT GRANTS (25 Marks)

(i) Differentiate a Government grant from a Government assistance **(3 Marks)**

Government grant Is assistance by government in the form of transfers of resources to an entity in return for past or future compliance with certain conditions relating to the operating activities of the entity Whereas **Government assistance** is a government action to generate an economic benefit for entities that meet qualifying criteria.

(ii) Under what conditions a Government grant should be recognised in a statement of profit, loss and other comprehensive income? **(2 Marks)**

- **Recognize** a government grant when there is reasonable assurance that

1. The grant will be received, and
2. The entity will comply with the conditions attached to the grant

(iii) Kwikwi (Kw) Ltd purchases a rakata-rikiti-rukutu (Music instruments system) for TZS120, 000,000. It received a government grant of 25% of the cost of the rakata-rikiti-rukutu. The rakata-rikiti-rukutu has an expected life of 10 years with an expected nil residual value. Profit for each year is TZS 100,000,000 (before depreciation).

Requirement

Show how the grant should be accounted for in the first three years under the two methods allowed in IAS 20 **(20 Points)**

Suggested solution

	TZS'000
Cost	120,000
expected life (years)	10
Grant percentage	25%
Profit for each year	100,000
Government grant in TZS(Cost*Grant percentage)	30,000
Depreciation (method(i)) (120m-120m*25%)/10yrs	9,000
Depreciation (method(ii)) (120m)/10yrs	12,000

Method (i) - Reducing the cost of the asset:			
SPLOCI – P/L	**Year 1**	**Year 2**	**Year 3**
	TZS'000	TZS'000	TZS'000
Profit before depreciation	100,000	100,000	100,000
Depreciation (Cost/expected life)	-9,000	-9,000	-9,000
Profit	**91,000**	**91,000**	**91,000**

SFP	Year 1	Year 2	Year 3
	TZS'000	TZS'000	TZS'000
NCA at Cost	90,000	90,000	90,000
Accumulated Depreciation	-9,000	-18,000	-27,000
Net Book Value	**81,000**	**72,000**	**63,000**

Method (ii) - Treating the grant as a deferred credit:			
SPLOCI – P/L	**Year 1**	**Year 2**	**Year 3**
	TZS'000	TZS'000	TZS'000
Profit before grant & depn	100,000	100,000	100,000
Depreciation	-12,000	-12,000	-12,000
Grant (grant/10)	3,000	3,000	3,000
Profit	**91,000**	**91,000**	**91,000**
SFP			
Non-current asset (cost)	120,000	120,000	120,000
Accumulated depreciation	-12,000	-24,000	-36,000
Net book value	108,000	96,000	84,000
Non-current liabilities			
Deferred Y - govt grants	24,000	21,000	18,000
Current liabilities			
Deferred Y - govt grants	3,000	3,000	3,000
Closing balance	**27,000**	**24,000**	**21,000**

C: ACCOUNTING FOR INVESTMENTS (10 Marks)

Highlight the four levels of investments and explain the relevant accounting treatments with reference to applicable accounting standards **(10 Marks)**

1. **Ordinary investment**

   Where the investor does not exercise **significant influence** over the operating and financial policies of the other entity. This is normally a holding of **less than 20%. Treat it as a normal financial assest.**

2. **Investment in an associate**

   Where the investor does exercise **significant influence** over the operating and financial policies of the other entity, which is normally through holdings of **20% or more, but less than 50%. Applying IAS 28 which uses equity method to account for an Associate**

3. **Investment in a joint venture**

   Where the investor **shares control** (through a contractual arrangement) jointly with others. Applying IFRS 11 to account for joint operations

4. **Investment in a subsidiary**

   Where the investor **controls** the operating and financial policies of the other entity, normally through holdings of

more than 50%. Applying IFRS 10, IFRS 3 etc to account for a subsidiary

D: SUBSEQUENT EVENTS (10 Marks)

Dang-Ding Limited's (Dang Ding) financial year ends on 31 December. On 20 December 2020, Dang Ding was involved in a court case with a customer who sued the company for delivering products where there was a dispute over the exact ingredients included in the products manufactured by Dang Ding. These products were delivered to the customer in October 2020. The details of the case were heard by 22 December but the judge decided to reserve her judgment until 8 January 2021. On 8 January 2021, the judge ruled in favour of the customer, awarding it damages of TZS 100,000,000.

Required: Explain the nature and treatment of this event as in the Dang Ding's financial reports for year ended 31 December 2020.

Solution

Per paragraph 9 (a) of IAS 10, this is an **adjusting event**. The event took place during the reporting period and the settlement after the reporting period of the court case confirms that Dang Ding Limited had a present obligation at the end of the reporting period. The entity adjusts any previously recognised provision related to this court case in *accordance with IAS 37 Provisions, Contingent Liabilities and Contingent Assets* or **recognises a new provision**.

On **recognising a new provision** the entry would be

Dr Provisions for Litigation costs (P&L) 100,000,000

Cr Contingent Liability (litigation settlement) (SFP) 100,000,000

Being recognition of provisions for litigation settlement