

Specimen Exam 1

Exam Name: Business and Sustainability Reporting (S1 INT)

Time Allowed: 3 hours 15 minutes

Pass Mark: 50%

This exam contains 2 sections:

Section A:

1 question, worth 50 marks

Section B:

1 question worth 30 marks

1 question worth 20 marks

Total 100 marks

Section A

Question 1

Pretalo Co (Pretalo) is the parent of the Pretalo Group. All group companies prepare financial statements in accordance with IFRS Accounting Standards. The financial year end is 31 December 20X5.

The directors are unsure of the accounting treatment of several transactions and require assistance correcting the draft consolidated financial statements.

The following **exhibits** provide information relevant to the question:

1. Soritti Co – information about Pretalo’s acquisition of Soritti Co (Soritti)
2. Trepilo Co – information about Pretalo’s purchase of Trepilo Co (Trepilo), a company with a functional currency of the lunar
3. Government grants – information about government grants received by Pretalo in relation to research and development expenditure
4. New lithium supplier – information about an new lithium supplier, which received negative press attention about its sustainability credentials during the year
5. Draft CSOFP – the draft consolidated statement of financial position (CSOFP) for the Pretalo Group as at 31 December 20X5

1 Soritti Co

On 1 March 20X5, Pretalo purchased 10% of Soritti’s equity share capital for a cash payment of \$66 million. Pretalo did not make any elections, as permitted by IFRS 9 *Financial Instruments*. In the draft CSOFP, this investment is held within financial assets at its original cost. On 31 December 20X5, the fair value of the 10% holding in Soritti was \$70 million.

On 31 December 20X5, Pretalo obtained control of Soritti by purchasing a further 60% of its equity share capital. Consideration transferred was as follows:

- cash paid of \$300 million; and
- cash of \$130 million to be paid on 31 December 20X6.

No accounting entries have been recognised in respect of the deferred cash in the draft CSOFP.

On 31 December 20X5, the net assets of Soritti had a total carrying amount of \$440 million in its separate financial statements. These net assets have been included line-by-line at their carrying amounts in the draft CSOFP.

On 31 December 20X5, Soritti was partway through development of a new light-weight battery to be used in electric vehicles. Soritti has recognised a development asset with a carrying amount of \$35 million in its separate financial statements. The fair value of the development asset on the basis that market participants would lock up the project and cease development in order to prevent competition with their own products is \$55 million. The fair value of the development asset on the basis that market participants would continue development activities until the project is complete is \$80 million. No adjustments have been made in respect of the fair value of the development asset.

The tax base of the development asset is the same as its carrying amount in Soritti's separate financial statements. The applicable tax rate is 20%.

The Pretalo group correctly measured and recognised the non-controlling interest at acquisition at its fair value of \$210 million. Goodwill arising on the acquisition of Soritti was calculated as follows:

	\$m
Cash consideration	300
Non-controlling interest at acquisition	210
Carrying amount of Soritti's net assets at acquisition	(440)
Goodwill	70

Where relevant, a discount rate of 5% should be used.

2 Trepilo Co

The Pretalo Group has a functional currency of the dollar (\$).

On 1 April 20X5, Pretalo obtained significant influence over Trepilo Co (Trepilo) by purchasing 25% of its equity share capital. Trepilo's functional currency is the lunar (LR). Pretalo paid LR106 million for the equity shares.

In its separate financial statements for the year ended 31 December 20X5, Trepilo reported the following:

	LR(m)
Profit	28
Change in revaluation surplus relating to property, plant and equipment	10

It should be assumed that all income and expenses accrued evenly over the year.

Information about foreign exchange rates is provided below:

Date	LR to \$1
1 April 20X5	2.5

31 December 20X5	2.9
Average for period 1 April 20X5 – 31 December 20X5	2.7

In the draft CSOFP, Pretalo has recognised its investment in Trepilo within ‘investment in associates’ at \$42.4 million (LR106m/2.5). No other accounting entries have been recognised.

3 Government grants

Pretalo is a company which manufactures electrical components, some of which contain a hazardous material. During the year ended 31 December 20X5, Pretalo commenced a project to research and develop an alternative, non-hazardous material to use in the manufacturing of its components. The following costs were incurred.

	\$m
Research expenditure	46
Qualifying development expenditure	25

Development was successfully completed on 1 December 20X5 and was attributed a useful life of five years. The research and development costs, and any amortisation of these costs, were correctly accounted for in accordance with IAS 38 *Intangible Assets*.

During the year ended 31 December 20X5, Pretalo received two government grants in relation to this project. Pretalo received \$10 million to compensate it for its research expenditure and \$20 million to compensate it for its development expenditure.

When received, the government grants were recognised within current liabilities. No other accounting entries have been recognised in relation to these government grants.

When an accounting policy choice exists, Pretalo chooses the option which minimises its reported liabilities.

4 New lithium supplier

You are the chief accountant at Pretalo. You are an ACCA member.

Pretalo is a company which manufactures electrical components, including mobile phone batteries. Pretalo’s website and investor presentations promote its commitment to net zero, workers’ rights, and improving the lives of people in the communities affected by its value chain.

Pretalo's batteries contain several precious metals, including lithium. Lithium is often found in areas which suffer from drought conditions. The process of extracting lithium is highly water intensive.

In January 20X5, Pretalo switched to a new lithium supplier, a non-listed company called Capubalo Co (Capubalo). Pretalo's operations director owns 55% of the equity share capital of Capubalo.

In December 20X5, a major national newspaper ran a series of articles about Capubalo, accusing it of exceeding its water-usage quota.

Pretalo's biggest customer contract is due to expire in 20X6. Pretalo has been told by this customer that sustainability-related issues will be a significant factor in deciding whether the contract will be renewed.

The finance director, an ACCA member, called you (the chief accountant) into a meeting and said the following:

'If we lose this customer contract, we will have to undertake a large redundancy programme. We value our workers – I do not want them to lose their jobs. Right now, Capubalo's reputation is poor so please make sure that there is no reference to them in our financial statements for the year ended 31 December 20X5.'

5 Draft CSOFP

The information below is replicated in the preformatted spreadsheet response option.

Draft consolidated statement of financial position as at 31 December 20X5		
		\$m
Assets		
Non-current assets		
Property, plant and equipment	401.00	
Investment in associates	42.40	
Intangible assets	345.00	
Financial assets	104.00	
Goodwill	122.60	
	1,015.00	
Current assets	273.00	
Total assets	1,288.00	
Equity		
Share capital	85.00	
Translation reserve	15.00	
Other components of equity	134.00	
Retained earnings	413.00	
	647.00	
Non-controlling interest	326.00	
Total equity	973.00	
Liabilities		
Non-current liabilities		
Loans	80.00	
Net deferred tax liabilities	99.00	
	179.00	
Current liabilities	136.00	
Total liabilities	315.00	
Total equity and liabilities	1,288.00	

Requirements:

You are the chief accountant at the Pretalo Group. All group companies prepare financial statements in accordance with IFRS Accounting Standards. The financial year end is 31 December 20X5. The date is February 20X6.

(a) Prepare a report for the directors of Pretalo which addresses the following requirements:

(i) Advise, with supporting calculations, on how to correct the accounting treatment of Soritti in the consolidated financial statements for the year ended 31 December 20X5. You should include a calculation of the goodwill arising on the acquisition of Soritti.

(10 marks)

(ii) Advise, with supporting calculations, on how to correct the accounting treatment of Trepilo in the consolidated financial statements for the year ended 31 December 20X5.

(8 marks)

(iii) Advise, with supporting calculations, on how to correct the accounting treatment of the government grants in the consolidated financial statements for the year ended 31 December 20X5.

(5 marks)

(iv) Using exhibits 1 – 3, prepare a corrected consolidated statement of financial position as at 31 December 20X5 by adjusting the draft statement provided in the preformatted spreadsheet response option.

(13 marks)

Professional skills marks will be awarded for the demonstration of skill in communication and analysis and evaluation in your answer.

(6 marks)

(b) Using exhibit 4, evaluate, in accordance with the ACCA Code of Ethics and Conduct, the ethical issues relating to the new lithium supplier and recommend the actions which you (the chief accountant) should take to minimise or eliminate those issues.

(8 marks)

(50 marks)

Section B

Question 2

Drytat Co (Drytat) is a consultancy firm. It prepares financial statements in accordance with IFRS Accounting Standards. The financial year end is 31 December 20X5.

The directors are unsure of the accounting treatment of several transactions.

The following **exhibits** provide information relevant to the question:

1. Artificial intelligence – information about Drytat’s new sustainability department, as well as a revenue recognition accounting policy produced by a generative artificial intelligence (AI) programme
2. Land and lease agreement – information about land purchased in the prior financial year, which was leased out in the current financial year
3. Financial asset – information about Drytat’s purchase of loan notes which were issued by a listed company

1 Artificial intelligence

During the year ended 31 December 20X5, Drytat set up a sustainability department, which offers professional opinions on the viability of customers’ proposed sustainability-related investments.

The amount of time spent on each contract varies from several weeks to six months. When the work is completed, Drytat issues a report to its customer, which contains its professional opinion as well as the research and evidence collected to support this opinion. Each report is specific to the customer’s business, and the report is prohibited from being distributed to other companies.

The customer pays Drytat on receipt of the report. However, if the customer terminates a contract before completion, it must immediately compensate Drytat for all incurred costs plus a typical profit margin of 30%. Drytat’s costs are not incurred equally over the contract duration, with a greater proportion incurred in the initial stages of the project when it is most labour-intensive.

All contracts have a fixed price, which is negotiated between Drytat and the customer before contract commencement. To attract new business, Drytat’s sustainability department offers significant credit periods. Depending on the credit worthiness of its customers, credit terms range from between three months and six months from the date the report is issued.

The directors have used generative artificial intelligence (AI) to produce an accounting policy for the recognition of revenue arising from the sustainability department’s work:

Revenue is recognised at the point at which control transfers. Drytat should therefore recognise revenue on the date when the final report is issued to the customer. To reflect the credit period offered to customers, the amount of revenue recognised on this date should be equal to the fixed contract price, net of sales tax, and discounted to its present value. A receivable should be recognised for the same amount.

2 Land and lease agreement

On 1 November 20X4, Drytat purchased land adjacent to its head office and paid \$3 million. The land was purchased to be used as an employee car park, as well as for the construction of a solar farm which would generate the electricity required to power the head office. The land was correctly recognised as property, plant and equipment and measured at its cost.

During 20X5, occupancy levels of the existing head office declined because of an increase in the number of Drytat’s employees who were allowed to work from home. As a result, in August 20X5, the directors of Drytat decided that an employee car park was no longer needed. The directors also raised concerns about the complexity and risk of the solar farm. In October 20X5, the directors decided to abandon the solar farm project and made the decision to lease out the land instead.

On 1 November 20X5, Drytat signed a lease agreement with Oodox Co (Oodox), a company which develops solar farms. Under the terms of the lease agreement, Oodox, as the lessee, has unrestricted use of the land for twenty years and will be entitled to all income from the electricity produced.

Under the terms of the lease agreement, Drytat will receive \$75,000 every six months, with payments commencing on 30 April 20X6.

The fair value of the land was as follows:

	\$m
1 August 20X5	3.1
1 November 20X5	3.3
31 December 20X5	3.4

Drytat measures assets at fair value whenever permitted by IFRS Accounting Standards, except for property, plant and equipment, which is measured using the cost model.

The directors are unsure how to account for Drytat’s land and its lease agreement. Investing in land and property is not one of Drytat’s main business activities.

3 Financial asset

The directors of Drytat decided to increase investment in financial assets. On 1 January 20X5, Drytat purchased loan notes which were issued by a listed company, Erolt Co (Erolt), for their nominal (par) value of \$15 million. Erolt is an online clothing retailer.

Drytat will receive interest from Erolt on 31 December each year at a rate of 4% of nominal value. The loan notes will be redeemed at a premium in five years' time. The effective rate of interest is 6%.

Drytat purchases loan notes with the intention of holding them to maturity. However, it has historically sold its investments in loan notes if financial instruments with higher returns become available. Investing in loan notes is not one of Drytat's main business activities.

During August 20X5, it was widely reported that Erolt was the victim of a major cyber-attack. This meant that it was unable to accept customer orders between September 20X5 and November 20X5. In December 20X5, Erolt began to accept orders again, although outstanding issues with its inventory system meant that there were shortages of its most popular products, as well as significant delays in shipping orders to its customers.

On 31 December 20X5, Drytat received the interest due from Erolt. On this date, the fair value of Drytat's investment in Erolt's loan notes was \$11 million. The fair value of the loan notes of other similar retail companies increased during the year ended 31 December 20X5.

At 31 December 20X5, Drytat calculated the following amounts in relation to its investment in Erolt's loan notes:

	\$m
12-month expected credit losses	0.5
Lifetime expected credit losses	1.8

The directors are unsure how to account for Drytat's financial asset and the expected credit losses.

Requirements:

(a) Assess whether the advice produced by the generative artificial intelligence (AI) programme is in accordance with IFRS 15 *Revenue from Contracts with Customers*.

(9 marks)

(b) Advise, with supporting calculations, on the accounting treatment of the land and the lease agreement in Drytat’s financial statements for the year ended 31 December 20X5.

(8 marks)

(c) Advise, with supporting calculations, on the accounting treatment of the financial asset and its expected credit losses in Drytat’s financial statements for the year ended 31 December 20X5.

(9 marks)

Professional skills marks will be awarded for the demonstration of skill in scepticism and analysis and evaluation in your answer.

(4 marks)

(30 marks)

Question 3

Greenchaff Co (Greenchaff) operates in the supermarket industry. It prepares financial statements in accordance with IFRS Accounting Standards and a sustainability report in accordance with IFRS Sustainability Disclosure Standards. The financial year end is 31 December 20X5.

The directors of Greenchaff require advice on several issues.

The following **exhibits** provide information relevant to the question:

1. Risks and opportunities – information which is relevant to identifying Greenchaff’s sustainability-related risks and opportunities
2. Greenhouse gas emissions disclosure – the draft greenhouse gas emissions disclosure from Greenchaff’s sustainability report for the year ended 31 December 20X5
3. Share options – information about a share option scheme granted to senior managers in the previous financial year

1 Risks and opportunities

Greenchaff is a premium-priced retailer in the supermarket industry. It is well known for its sustainability focus, and has publicly committed to reducing greenhouse gas emissions, minimising waste, and improving animal welfare standards among its meat suppliers. In a consumer survey in a national newspaper, Greenchaff was voted the ‘most ethical supermarket’.

In the country where Greenchaff operates, the two leading discount supermarket retailers continue to increase their market share. Greenchaff’s market share has, so far, remained constant. Although higher prices remain a barrier to ethical consumerism for some customers, those with more disposable income are willing to pay a substantial premium to buy from retailers whose ethics and morals align with their own.

Due to climate change, the frequency and severity of extreme weather events has increased. This means that there has been heavier rainfall and flooding in some parts of the world, and increased incidences of droughts and wildfires in others. These weather patterns have affected crop yields, causing Greenchaff’s suppliers to increase their prices.

Greenchaff delivers products to customers who order online. Greenchaff plans to switch all its remaining petrol delivery vans to electric models in the next two years. The cost of electricity per kilometre is less than the cost of petrol per kilometre.

Some of Greenchaff’s warehouses are in coastal areas, and these have been affected by increased incidences of flooding as sea levels have risen.

In March 20X6, the country where Greenchaff operates will introduce a carbon tax on companies. The amount of tax payable will depend on greenhouse gas emissions.

2 Greenhouse gas emissions disclosure

Greenchaff’s chief accountant has produced a draft of the greenhouse gas emissions disclosure for inclusion in the sustainability report for the year ended 31 December 20X5. This draft disclosure is presented below:

	20X5
	tCO₂e
Net Scope 1 emissions	415,348
Net other emissions	636,558

Total	1,051,906

Greenhouse gas emissions were measured in accordance with the *Greenhouse Gas Protocol: A Corporate Accounting and Reporting Standard (2004)*.

3 Share options

On 1 January 20X4, Greenchaff granted 20,000 share options to its 130 senior managers. The share options vest if the senior managers are still employed on 31 December 20X6, and if Greenchaff’s total net greenhouse gas emissions fall by 40% between 1 January 20X4 and 31 December 20X6.

On 31 December 20X4, it was expected that 120 of the senior managers would remain employed on 30 September 20X6. On 31 December 20X4, the directors forecasted that Greenchaff’s total net greenhouse gas emissions would fall by 45% between 1 January 20X4 and 31 December 20X6.

On 31 December 20X5, it was expected that 100 of the senior managers would remain employed on 30 September 20X6. During the financial year, greenhouse gas emissions were higher than anticipated because Greenchaff opened several new stores. On 31 December 20X5, the directors forecasted that Greenchaff’s total net greenhouse gas emissions would fall by 30% between 1 January 20X4 and 31 December 20X6.

The fair value of one of Greenchaff’s share options, determined using an option pricing model, was as follows:

	\$
1 January 20X4	6.30
31 December 20X4	5.70
31 December 20X5	4.20

The share option scheme was correctly measured and recognised in the year ended 31 December 20X4.

Requirements:

(a) Advise on the sustainability-related risks and opportunities which could reasonably be expected to affect Greenchaff’s prospects.

(6 marks)

(b) Advise why the greenhouse gas emissions disclosure does not comply with IFRS Sustainability Disclosure Standards.

(4 marks)

(c) (i) Advise, with supporting calculations, on the accounting treatment of the share options in the financial statements for the year ended 31 December 20X5.

(4 marks)

(ii) Evaluate the impact of management estimates and judgements on the amounts recognised in the financial statements in respect of the share options.

(4 marks)

Professional skills marks will be awarded for the demonstration of skill in commercial acumen in your answer.

(2 marks)

(20 marks)