<u>SECTION A – CASE QUESTIONS</u> (Total: 50 marks)

Answer ALL of the following questions. Marks will be awarded for logical argumentation and appropriate presentation of the answers.

CASE

Assume that you are Miss Melody Li, the accounting manager of Magic Holding Limited (MHL), which is a company incorporated in Hong Kong. MHL's functional and presentation currency is the Hong Kong dollar (HKD).

On 31 December 2011, MHL acquired 80% of the ordinary share capital of Stone Dove Limited (SDL), which is located in Australia. At the date of acquisition, SDL's share capital was 24 million Australian dollars (AUD24 million) and the retained earnings were AUD30 million. SDL had not issued any share capital since its acquisition by MHL. The following financial statements relate to MHL and SDL for the year ended 31 December 2012.

Statement of retained earnings of MHL and SDL for the year ended 31 December 2012

	MHL	SDL
	HKD'000	AUD'000
Retained earnings, 1 January	694,500	30,000
Profit after tax	90,000	10,000
Retained earnings, 31 December	*784,500*	*40,000*

Statement of financial position for MHL and SDL as at 31 December 2012

	MHL	SDL
	HKD'000	AUD'000
ASSETS		
Non-current assets	1,170,000	76,000
Investment in SDL	427,500	-
Current assets		
Inventory	225,000	6,000
Accounts receivable	120,000	12,000
Cash	27,000	6,600
Total assets	*1,969,500*	*100,600*
EQUITY AND LIABILITIES		
Share capital	750,000	24,000
Retained earnings	784,500	40,000
	1,534,500	*64,000*
Non-current liabilities	120,000	32,000
Current liabilities	315,000	4,600
Total equity and liabilities	*1,969,500*	*100,600*

Additional information:

- The book values of SDL's assets and liabilities approximated their fair values except for a patent whose fair value was greater than the book value by AUD10 million on 31 December 2011. SDL had not revalued its assets since its acquisition by MHL. The patent had a remaining economic life of ten years from 31 December 2011 and no residual value. The patent is recorded as a non-current asset.

- Non-controlling interests are measured at their proportionate share in the recognised amounts of the acquiree's identifiable net assets.

- The Australia dollar is the currency of the primary economic environment in which SDL operates. Therefore, the functional currency of SDL is considered to be the Australian dollar (AUD).

- The following exchange rates are relevant to the financial statements:

Date	AUD1 to HKD
31 December 2011	7.60
31 December 2012	8.10
Average rate for 2012	7.80

- There was no impairment of goodwill since the date of acquisition.

- The relevant Australian corporate tax rate is 30%.

Earnings per share

To calculate the earnings per share of MHL for the year ended 31 December 2012, the following information has been obtained:

The number of ordinary shares outstanding at the beginning of the year, i.e. 1 January 2012, was 23,250,000. On 1 October 2012, 5,000,000 shares of MHL has been issued for cash.

Warrants to buy 3,000,000 ordinary shares of MHL at HKD60 per share for a period of five years were issued on 1 January 2012. No warrants were exercised in 2012.

On 1 January 2012, convertible bonds with a principal amount of HKD10 million due in 10 years were issued for cash at HKD1,000 at par. The convertible bonds have a coupon rate of 4% per annum, which is equivalent to the effective interest rate. Each HKD1,000 bond is convertible into 20 ordinary shares of MHL. No bonds were converted in 2012.

The average market price of an ordinary share of MHL from 1 January 2012 to 31 December 2012 was HKD100. The relevant Hong Kong tax rate is 16.5%.

Intangible assets

One of the directors, Ms. Tess Chow, noticed that a patent of SDL has been recognised in the consolidated financial statements of MHL at its fair value on 31 December 2011 though it is only recognised on cost basis in the financial statements of SDL. She would like to recognise also the intangible assets of MHL in the consolidated financial statements of MHL at their fair values and thus she has asked for your opinion on the following items:

- MHL has a brand name, Magica, which has become well known since MHL developed it ten years ago. Valuation experts have valued the brand name at HKD5 million. Tess would like to recognise this brand name as an intangible asset and report it at HKD5 million in the consolidated financial statements of MHL.

- MHL owns a 20-year patent which it acquired five years ago for HKD2 million and recongised at cost in the separate financial statements of MHL. Valuation experts have valued this patent at HKD10 million. Tess would like to report this patent at HKD10 million in the consolidated financial statements of MHL.

Question 1 **(50 marks – approximately 90 minutes)**

Assume that you are Melody Li, the accounting manager, and you are required to draft a memorandum to Ms. Tess Chow, a Director of MHL. In your memorandum, you should:

(a) **For the consolidated financial statements of MHL, advise the appropriate accounting treatment for the brand name and the patent of MHL as mentioned by Tess.**

(6 marks)

(b) **Calculate the basic and diluted earnings per share attributable to ordinary equity holders of the parent for the consolidated financial statements of MHL for the year ended 31 December 2012, on the basis that the profit attributable to ordinary equity holders of the parent for the year ended 31 December 2012 is HKD147,189,600.**

(9 marks)

(c) **Calculate the total translation reserves to be presented in the consolidated statement of financial position of MHL as at 31 December 2012.**

(You may consider analyse into translation reserves on net assets, fair value adjustment and goodwill, or use other presentation method to calculate the translation reserves).

(14 marks)

(d) **Prepare an annex to your memorandum showing the worksheets for the consolidated statement of financial position of MHL as at 31 December 2012.**

(21 marks)

(Recognise the deferred tax implications at the relevant tax rate. Assume that appropriate accounting treatments have been made in the statements of retained earnings and statements of financial position as presented.

Consolidation adjustments are to be shown in the form of a worksheet. For Question 1(d), you may use the template in green colour paper provide and/or the script booklet for Case Questions to prepare your answers. You have to show the detailed calculations of each figure, but journal entries are **not** required).

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End of Section A

SECTION B – ESSAY / SHORT QUESTIONS (Total: 50 marks)

Answer ALL of the following questions. Marks will be awarded for logical argumentation and appropriate presentation of the answers.

Question 2 **(10 marks – approximately 18 minutes)**

Rider Games Inc. (RGI) acquired a patented technology that expires in 10 years and a licence to use a custom made software for 5 years at consideration of HKD4.5 million and HKD2.4 million respectively on 1 October 2009. Amortisation is calculated on an annual basis over a 5-year estimated useful life for both intangible assets. For tax purposes, the cost of a patent is a non-deductible expenditure and the software licence is fully deductible in the year of acquisition. Tax rate applicable to RGI is 30%.

Required:

(a) Calculate the temporary differences and deferred tax asset / liability of RGI at the year end date of 30 September 2013.

(6 marks)

(b) The director of the company asked the financial controller the following question. "If the company can get full tax deduction for the software licence, why don't we state the whole HKD6.9 million as the cost of acquisition for the software licence in our financial statements? Besides, as software is an intangible item, we can use our own computer and printer to create more agreements and invoices in order to record more acquisitions of software in the financial statements".

Being the financial controller of RGI, **explain to the director his duties and responsibilities in connection with the subject matter and the preparation of the financial statements.**

(4 marks)

Question 3 (23 marks – approximately 41 minutes)

Ralland Corp (RLC), a property development and investment company, has the following properties at 31 December 2012, the end of the previous financial year:

	Carrying amount	Original cost
	HKD'M	HKD'M
Investment property – Tower A	25.8	18.6
Investment property under construction – Tower B	14.2	10.5
Office building – Tower C	28.5	30.0
Office building – Tower D	17.1	18.0

The company adopts the cost model for owned used property and the fair value model for investment property. All four properties were acquired in 2010 with an expected useful life of 50 years. Depreciation, if applicable, is calculated on a monthly basis and commenced on 1 July 2010.

To enhance the profitability of the property portfolio, RLC carried out the following activities:

(a) Moved its headquarter from Tower C to Tower A upon the expiry of the lease with the tenant at the end of March 2013;

(b) Refurnished Tower C at a cost of HKD1.8 million in April and May 2013 and then rented it out to earn rental income since 1 June 2013;

(c) Completed the construction of Tower B by end of May 2013 with additional expenditure of HKD3.8 million; and

(d) Sold Tower D at HKD30 million to an independent third party and entered into a lease of the premises for 2 years at a market rental of HKD80,000 per month on 1 May 2013.

An external valuer has been engaged to perform a valuation for all the properties except Tower D and the estimated fair values at 31 March 2013 and 30 June 2013 are as follows:

	31 March 2013	30 June 2013
	HKD'M	HKD'M
Tower A	26.4	27.2
Tower B	17.4	19.2
Tower C	38.0	40.0

Required:

(a) **Explain the implication of the activities occurred during the six months ended 30 June 2013 on the classification and the effective date for each of the properties of RLC.**

(6 marks)

(b) **Determine the carrying amount at 30 June 2013 for each of the properties owned by RLC.**

(5 marks)

(c) **Identify the nature and quantify the amount of each income and expenses item to be recognised in the statement of comprehensive income for the six months ended 30 June 2013 of RLC in relation to each of these properties.**

(12 marks)

Note: Ignore tax effect and rental income from investment properties.

Question 4 **(17 marks – approximately 31 minutes)**

XPrint Limited (XP), a printer manufacturer, had the following balances under current liabilities as presented in its annual management accounts as at 31 March 2013:

	HKD'000
Provision for discount coupon	750
Warranty provision	5,640
Litigation provision	8,000

XP has developed a new printers model and targets to promote it to its old customers. A letter was issued to 1,500 old customers to offer them a HKD500 discount to exchange the old model for the new one on or before 30 April 2013. It is expected that a profit will still be made at a discounted selling price.

XP provides a one year warranty provision for all the printers it sells. Customers can request a free of charge repair service during the warranty period. A provision of HKD400,000 was made per month. Total expenditure incurred for this service, mainly costs for labour and parts replacement, was HKD3,160,000 during the year, which represented around 0.8% of the sales in the previous year. The ratio for the past five years ranged from 0.64% to 1%. Total sales for the current year amounted to HKD437 million.

XP was named as a defendant in a writ of summons with a statement of claim by another printer producer in relation to the alleged infringement of patent of design, claiming for a sum of HKD9.6 million. XP intended to settle with the plaintiff out of court. An offer letter of HKD3.8 million in compensation was given to the plaintiff in January 2013 and a counter-offer of HKD5 million payable within one month was received in early March 2013. The Board of XP approved to accept the counter-offer of the plaintiff and made the payment on 20 April 2013. The lawyer issued a fee note of HKD650,000 to XP on 1 May 2013 for the relevant legal service provided during the year. Other than the existing HKD8 million provision relating to this case, XP had no other provision.

Required:

(a) **Explain and comment the appropriateness of the amount of the provisions recognised in the management accounts at 31 March 2013.**

(14 marks)

(b) **The marketing director wrote the following email to the chief financial officer on 29 March 2013:** *"We just concluded the contract terms of a television advertisement for the new products to be launched in the coming May with a cost of HKD1.8 million. As there was still an un-utilised budget of HKD1.2 million for marketing expenses for this year, I suggest making a partial provision for this expenditure first, please approve."* **Do you agree the recognition of the provision at 31 March 2013?**

(3 marks)

* * * END OF EXAMINATION PAPER * * *