SECTION A – CASE QUESTIONS (Total: 50 marks)

To: Ms. Janice Lam, Director of DBL
From: Raymond Wong, Accounting Manager, DBL
c.c.: Lucas Chong, Josiah Wong, Andrea Cheung (Directors)
Date: dd/mm/yyyy
Subject: Condensed consolidated financial statements of DBL for the six months ended 31 March 2012

I refer to your e-mail dated 7 May 2012 regarding your queries about the draft condensed consolidated financial statements of DBL for the six months ended 31 March 2012.

Answer 1(a)

Compliance with HKFRS

HKAS 34.19 specifies that if an entity's interim financial report is in compliance with HKAS 34, that fact shall be disclosed.

However, an interim financial report shall not be described as complying with HKFRSs unless it complies with all the requirements of HKFRSs.

Condensed financial statements do not comply with all the requirements of HKFRSs.

Therefore DBL's interim financial report cannot be described as complying with HKFRSs.

Answer 1(b)

Segment information

In accordance with HKAS 34.16A(g), disclosure of segment information is required in an entity's interim financial report only if HKFRS 8 Operating Segments requires that entity to disclose segment information in its annual financial statements.

HKFRS 8 applies to the separate financial statements of an entity (HKFRS 8.2(a)(i)) and the consolidated financial statements of a group with a parent (HKFRS 8.2(b)(i)) whose equity instruments are traded in a public market. As DBL is listed on the Main Board of the Stock Exchange of Hong Kong, segment information is required to be disclosed.

Therefore, DBL should disclose the relevant segment information under the HKAS 34.16A(g) in its interim financial report since HKFRS 8 Operating Segments does require DBL to disclose segment information in its annual financial statements.

CPA Hong Kong Institute of Certified Public Accountants 香港會計師公會

Answer 1(c)

Related party relationship

HKAS 24 (Revised) defines a related party as a person or entity that is related to the entity that is preparing its financial statements.
A person is related to a reporting entity if that person is a member of the key management personnel of the reporting entity or of a parent of the reporting entity (HKAS 24.9(a)(iii)).

Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of the entity, directly or indirectly, including any director (whether executive or otherwise) of that entity.

As you (Janice) are the director of DBL, you are a related party of DBL (key management personnel) and STF (key personnel of the parent of STF) pursuant to HKAS 24.9(a)).

DBL and STF are related parties to each other according to HKAS 24.9(b)(i) since they are members of the same group. In addition, for financial statements of both DBL and STF, BTV is a related party as BTV is controlled by you (Janice), who is a related party falling into the scope of HKAS 24.9(a) (HKAS 24.9(b)(vi)).

For BTV's financial statements, DBL and STF are related parties to BTV because BTV is controlled by you and you are a key management personnel of DBL which is the parent of STF (HKAS 24.9(b)(vii) and (a)(i)).

Answer 1(d)

Contract with FYL

The contract with FYL meets the definition of a derivative (HKFRS 9) because its value changes in response to changes in an underlying variable (HIBOR), there is no initial net investment, and settlements occur at future dates.

The contractual effect of the loans is the equivalent of an interest rate swap arrangement with no initial net investment. Therefore, it should be accounted for as a derivative under HKFRS 9.

Guidance on implementing HKFRS 9 Financial Instruments specifies that non-derivative transactions should be aggregated and treated as a derivative when the transactions result, in substance, in a derivative.

Indicators of this would include:

- they are entered into at the same time and in contemplation of one another.
- they have the same counterparty.
- they relate to the same risk.
- there is no apparent economic need or substantive business purpose for structuring the transactions separately that could not also have been accomplished in a single transaction.

Under HKFRS 9, DBL should recognise the derivative as a financial asset or a financial liability in its statement of financial position when, and only when, DBL becomes party to the contractual provisions of the instrument.

The default assumption with regard to derivatives under HKFRS 9 is that they are to be measured at fair value with changes in fair value taken to profit and loss.

I hope the above explanation has answered your questions. For the details, please refer to the annex. Please feel free to contact me if you have further queries.

Best regards,
Raymond Wong

Answer 1(e)

Annex

(i) Worksheet for the condensed consolidated statement of comprehensive income for the six months ended 31 March 2012

	DBL	STF	Eliminations			Consolidated
	$000	$000	Dr($000)	working	Cr($000)	$000
Sales	2,400,000	1,152,000	144,000	W7		3,408,000
Cost of sales	(1,536,000)	(769,000)	16,800	W7	144,000	(2,165,800)
				W6	12,000	
Gross profit	864,000	383,000				1,242,200
Other income (including dividend income)	38,000	--	33,600	W3		4,400
Distribution costs	(90,000)	(69,000)				(159,000)
Administrative expenses	(150,000)	(75,000)	5,000	W2		(230,000)
Finance costs	(172,000)	(34,000)				(206,000)
Profit before tax	490,000	205,000				651,600
Income tax expense	(106,000)	(61,000)	1,980	W6/W7	2,772	(165,383)
				W2	825	
Profit for the period	384,000	144,000				486,217
Other comprehensive income: revaluation surplus	180,000	36,000				216,000
Total comprehensive income	564,000	180,000				702,217
Profit attributable to:						
Owners of the parent						445,472
Non-controlling interests			40,745	W4		40,745
						486,217
Total comprehensive income attributable to:						
Owners of the parent						650,672
Non-controlling interests			51,545	W4&4a		51,545
						702,217

CPA Hong Kong Institute of Certified Public Accountants 香港會計師公會

(ii) Worksheet for the condensed consolidated statement of financial position as at 31 March 2012

	DBL	STF	Eliminations			Consolidated
	$000	$000	Dr($000)	working	Cr($000)	$000
Property, plant and equipment, net	1,824,000	788,000				2,612,000
Investment in STF, at cost	768,000	--		W1	768,000	--
Goodwill	--	--	133,240	W1		133,240
Other intangible assets, net	--	136,000	80,000	W1/W2	35,000	181,000
Deferred tax asset	--	--	2,772	W7		2,772
Inventory	1,536,000	648,000		W7	16,800	2,167,200
Trade and other receivables	750,000	420,000				1,170,000
Cash and cash equivalents	690,000	312,000				1,002,000
	5,568,000	2,304,000				7,268,212
Share capital	960,000	480,000	480,000	W1		960,000
Retained earnings	1,380,000	750,000				1,629,723
Revaluation surplus	300,000	66,000				339,200
	2,640,000	1,296,000				2,928,923
Non-controlling interests	--	--		W1	272,040	395,864
			9,000	W2	1,485	
			14,400	W3/W4	40,745	
				W4a	10,800	
				W5	91,200	
				W5a	6,000	
			3,600	W6	594	
Deferred tax liability			5,775	W2/W1	13,200	7,425
Trade and other payables	1,428,000	408,000				1,836,000
Long term loan	1,500,000	600,000				2,100,000
	5,568,000	2,304,000				7,268,212

CPA Hong Kong Institute of Certified Public Accountants 香港會計師公會

Working:

Reconciling consolidated retained earnings and consolidated revaluation surplus

	DBL	STF	Eliminations			Consolidated
	$'000	$'000	Dr($'000)	working	Cr($'000)	$'000
Retained earnings, 1 October 2011	1,092,000	654,000	21,000	W2	3,465	1,280,251
			8,400	W6	1,386	
			350,000	W1		
			91,200	W5		
Profit for the period attributable to the owners of the parent	384,000	144,000				445,472
Dividends declared	(96,000)	(48,000)		W3	48,000	(96,000)
Retained earnings, 31 March 2012	1,380,000	750,000				1,629,723

	DBL	STF	Eliminations			Consolidated
	$'000	$'000	Dr($'000)	working	Cr($'000)	$'000
Revaluation surplus, 1 October 2011	120,000	30,000	6,000	W5a		134,000
			10.000	W1		
Revaluation for the period attributable to the owners of the parent (less 10,800 for NCI)	180,000	36,000				205,200
Revaluation surplus, 31 March 2012	300,000	66,000				339,200

CPA Hong Kong Institute of Certified Public Accountants 香港會計師公會

Note: The journal entries are for illustrative purpose only. They are not required by the question.

W1 - Elimination of investment in subsidiary

			$'000	$'000
Dr	Share capital		480,000	
Dr	Retained earnings		350,000	
Dr	Revaluation reserve		10,000	
Dr	Goodwill		133,240	
Dr	Intangible assets		80,000	
	Cr	Deferred tax liability ($80m x16.5%)		13,200
	Cr	Investment in STF		768,000
	Cr	Non-controlling interests (BS) (906.8m x 30%)		272,040

W2 - Past and current amortisation on revalued intangible assets

				$'000	$'000
Dr	Opening retained earnings		($80m/8*3*70%)	21,000	
Dr	Non-controlling interests (BS)		($80m/8*3*30%)	9,000	
Dr	Amortisation		($80m/8*0.5)	5,000	
	Cr	Accumulated amortisation			35,000
Dr	Deferred tax liability		($35m x 16.5%)	5,775	
	Cr	Opening retained earnings	($21m x 16.5%)		3,465
	Cr	Non-controlling interests	($9m x 16.5%)		1,485
	Cr	Tax expense	($5m x 16.5%)		825

W3 - Eliminate dividend income

				$'000	$'000
Dr	Dividend income		($48m x 70%)	33,600	
Dr	Non-controlling interests (BS)		($48m x 30% NCI)	14,400	
	Cr	Dividends declared			48,000

W4 - Current income to Non-controlling interests

			$'000	$'000
Dr	Non-controlling interests (IS)		40,745	
	Cr Non-controlling interests (BS)			40,745

		$'000	$'000
Profit of STF before adjustment			144,000
Add: previous period's unrealised profit now realised	($36m-24m)	12,000	
Tax effects on previous period's unrealised profit	($12m x 16.5%)	(1,980)	10,020
Less: current period's unrealised profit	(35%*(144m - 96m))	(16,800)	
Tax effects on current period unrealised profit	($16.8m x 16.5%)	2,772	(14,028)
Less: amortisation on revalued intangible assets		(5,000)	
Tax effects on amortisation on revalued intangible assets	($5m x 16.5%)	825	(4,175)
Adjusted profit			135,817
Non-controlling interests' share (30%)			40,745

W4a - Current revaluation surplus to Non-controlling interests

			$'000	$'000
Dr	Non-controlling interests (IS)	($36m x 30% NCI)	10,800	
	Cr Non-controlling interests (BS)			10,800

W5 - Assign post-acquisition Retained Earnings to Non-controlling interests

			$'000	$'000
Dr	Opening retained earnings (from 1 October 2008 to 30 September 2011)	[30% NCI x($654m - 350m)]	91,200	
	Cr Non-controlling interests (BS)			91,200

CPA Hong Kong Institute of Certified Public Accountants 香港會計師公會

W5a - Assign post-acquisition revaluation surplus to Non-controlling interests

				$'000	$'000
Dr	Opening revaluation surplus (from 1 October 2008 to 30 September 2011)		[30% NCI x($30m - 10m)]	6,000	
	Cr	Non-controlling interests (BS)			6,000

W6 - Realisation of beginning unrealised profit in inventory

				$'000	$'000
Dr	Opening retained earnings			8,400	
Dr	Non-controlling interests (BS)		($12m x 30%)	3,600	
	Cr	Cost of sales	($36m - $24m)		12,000
Dr	Tax expense		($12m x 16.5%)	1,980	
	Cr	Opening retained earnings	($8.4m x 16.5%)		1,386
	Cr	Non-controlling interests (BS)	($3.6m x 16.5%)		594

W7 - Elimination of intercompany sale of inventory

				$'000	$'000
Dr	Sales			144,000	
	Cr	Cost of sales			144,000
Dr	Cost of sales		(48m x 35%)	16,800	
	Cr	Inventory			16,800
Dr	Deferred tax asset		($16.8m x 16.5%)	2,772	
	Cr	Tax expense			2,772

CPA Hong Kong Institute of Certified Public Accountants 香港會計師公會

Reconciliation of Non-controlling interests (BS):

Shareholders' equity of STF at 31 March 2012			1,296,000
Fair value adjustment of intangible assets		80,000	
Tax on fair value adjustment of intangible assets	(80m x 16.5%)	(13,200)	66,800
Accumulated amortisation on fair value adjustment of intangible assets	(80m/8x3.5)	(35,000)	
Tax on acc. amortisation on fair value adjustment of intangible assets		5,775	(29,225)
Unrealised profit on upstream sale		(16,800)	
Tax on unrealised profit on upstream sale		2,772	(14,028)
Adjusted shareholders' equity of STF at 31 March 2012			1,319,547
NCI's share @ 30%			395,864

or

			30% NCI
Shareholders' equity of STF at 31 March 2012		1,296,000	388,800
Fair value adjustment of intangible assets		80,000	24,000
Tax on fair value adjustment of intangible assets	(80m x 16.5%)	(13,200)	(3,960)
Accumulated amortisation on fair value adjustment of intangible assets	(80m/8x3.5)	(35,000)	(10,500)
Tax on acc. amortisation on fair value adjustment of intangible assets		5,775	1,733
Unrealised profit on upstream sale		(16,800)	(5,040)
Tax on unrealised profit on upstream sale		2,772	831
Adjusted shareholders' equity of STF at 31 March 2012		1,319,547	395,864

* * * END OF SECTION A * * *

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

Answer 2(a)

Amounts recognised in profit or loss for the year ended 30 September 2012:

		Contract A	Contract B	Total
		$'000	$'000	$'000
Revenue	W1	**9,800**	**26,000**	35,800
Cost of services recognised	W2	**(8,400)**	**(27,150)**	(35,550)
Profits (loss) recognised		**1,400**	**(1,150)**	250

Working:

1 Revenue:

	Contract A	Contract B
	$'000	$'000
Contract sum certified and billed to date	28,000	26,000
Less: Revenue previously recognised up to 30 September 2011	(18,200)	---
	9,800	26,000

CPA Hong Kong Institute of Certified Public Accountants 香港會計師公會

2 Cost of service recognised:

	Contract A	Contract B
	$'000	$'000
Total agreed contract sum	42,000	65,000
% of completion	28,000 / 42,000 x 100% = **66.67%**	26,000 / 65,000 x 10% =**40%**
Revised estimated total contract cost	36,000 x 100% = 36,000	63,000 x 105% = 66,150
Cost to recognised	36,000 x 66.67% = 24,000	66,150 x 40% = 26,460
Less: Cost recognised up to 30 September 2011	(15,600)	--
Sub-total **[A]**	= 8,400	= 26,460

Foreseeable loss recognised for Contract B:

		$'000
Estimated contract sum		65,000
Revised estimated total contract cost		(66,150)
Foreseeable loss		(1,150)
Less: Loss recognised (26,000 – 26,460)		460
Additional loss to recognise **[B]**		(690)
Total cost of service recognised **[A]+[B]**	8,400	27,150

Alternative for Contract B:

		Contract B
		$'000
Revised estimated total contract cost	(63,000 x 105%)	66,150
Less: Total contract sum		(65,000)
Total loss to be recognised, including foreseeable loss		1,150
Revenue recognised		26,000
Add: Total lost to be recognised		1,150
Total cost of service recognised		27,150

Answer 2(b)

The amounts to be disclosed and presented under HKAS 11 at 30 September 2012:

		Contract A	Contract B	Total
		$'000	$'000	$'000
Costs incurred		25,600	30,000	55,600
Recognised profits (loss)	W1	4,000	(1,150)	2,850
Progress billings		(28,000)	(26,000)	(54,000)
Amount due from customers for contract works		1,600	2,850	4,450
Receivable	W2	5,200	2,500	7,700

Working:

1. **Recognised profits for contract A:**
   Alternative 1 = $28,000,000 x (42,000,000 – 36,000,000) /42,000,000 = $4,000,000
   Alternative 2 = $18,200,000 – 15,600,000 + 1,400,000 = $4,000,000
   Alternative 3 = (42,000,000 – 36,000,000 x 66.67% = 4,000,000

2. **Receivable:**
   Contract A: ($28,000,000 – 22,800,000 = $5,200,000)
   Contract B: ($26,000,000 – 23,500,000 = $2,500,000)

Answer 3(a)

Based on the information provided in the question, the significant deterioration of Run Pro's sales performance is an impairment indicator. When such an indication exists, the entity shall estimate the recoverable amount of the asset of Run Pro.

The brand, being an intangible asset with indefinite useful life, and therefore no amortisation is recognised, is required to be tested for impairment at least annually, irrespective of whether there is any indication of impairment.

Accordingly, WSL is required to perform an asset impairment review in both Run Pro and Jog Pro at 30 June 2012.

Answer 3(b)

An asset or cash generating unit (CGU) is considered to be impaired when its recoverable amount declines below its carrying amount.

The recoverable amount of an asset or a CGU is the higher of its fair value less costs to sell and its value in use.

The recoverable amount is determined for an individual asset, unless the asset does not generate cash inflows that are largely independent of those from other assets or groups of assets.

CPA Hong Kong Institute of Certified Public Accountants 香港會計師公會

If that is the case, the recoverable amount is determined for the CGU to which the asset belongs, unless either:

- The asset's fair value less costs to sell is higher than its carrying amount; or
- The asset's value in use can be estimated to be close to its fair value less costs to sell and fair value less costs to sell can be determined.

A CGU is the smallest group of assets that generates largely independent cash inflows. This may be a single asset or group of assets.

Based on the information provided, each brand is considered as a cash generating unit. The value in use of the group of assets (i.e. the intangible asset, plant and equipment, developed cost capitalised and inventories) under individual brands and fair value less costs to sell of each of the two brands and individual categories of assets are determinable.

HKAS 36 has a bottom-up approach to impairment testing.

It is incorrect to compare the aggregate value in use with the total net assets of both brands to determine whether an individual brand or other asset is impaired.

Answer 3(c)

	Run Pro	Jog Pro
	$'000	$'000
Net assets of the CGU, other than inventories (a)	71,000	33,000
Value in use of the CGU (b)	64,000	60,000
Fair value less cost to sell of the CGU (c)	60,000	58,000
The recoverable amount (d) (The higher of (b) and (c))	64,000	60,000
Recoverable amount > Carrying amount of assets under the CGU	NO	YES
Impairment issue	YES	NO
Excess of net assets over the recoverable amount (d) – (a) = (e)	(7,000)	

According to the result above, the brand "Run Pro" is considered impaired and the impairment loss, HK$7 million, should be first allocated pro-rata on the basis of the carrying amount of each individual assets.

Allocation of impairment loss on pro-rata basis:

	Carrying value		Impairment Pro-rated	After allocation	
	$'000		$'000	$'000	
Brand	25,000	(7,000 x 25/71)	2,465	22,535	
Plant and equipment	40,000	(7,000 x 40/71)	3,944	36,056	(note 1)
Development cost	6,000	(7,000 x 6/71)	591	5,409	(note 2)
	71,000		7,000	64,000	

When allocating an impairment loss to individual assets within a CGU, the carrying amount of an individual asset should not be reduced below the highest of (i) its fair value less costs to sell (if determinable); (ii) its value in use (if determinable); and (iii) zero.

If this results in an amount being allocated to an asset which is less than its pro rata share of the impairment loss, the excess is allocated to the remaining assets within the CGU on a pro rated basis.

Note 1:	**Plant and Equipment**	
	Fair value less cost to sell (f)	36,000
	Carrying amount (g)	40,000
	(f) – (g) = (h)	(4,000)

Note 2:	**Development cost**	
	Capitalized without determinable fair value less costs to sell nor value in use (i)	6,000

Both development cost and plant & equipment fulfilled the requirement above and no excess impairment loss should reallocate to other assets.

Answer 4(a)

Bank loan A of $10,000,000 is classified as a current liability as it is due to be settled within twelve months after 31 December 2012.

Bank loan B of $8,000,000 is classified as a current liability as there is a clause in the loan agreement that gives the bank the unconditional right to call the loan at any time. CCL does not have an unconditional right to defer settlement of the liability for at least twelve months after 31 December 2012.

Answer 4(b)

Modification of the terms of a liability is accounted for as an extinguishment of the original liability and recognition of a new liability where the modification is substantial.

The terms are deemed to be substantially different if the net present value of the cash flows under the modified terms, including any fees paid and received, differs by at least 10 per cent from the net present value of the remaining cash flows of the existing liability, both discounted at the original effective interest rate of the original liability.

The interest for the original loan of $408,333 ($10,000,000 x 7% x 7/12) should be settled before the extension of the maturity date. Accordingly, the carrying amount of the bank loan for modification assessment is $10,000,000.

Total amount to be repaid on 31 January 2015 = $10,000,000 x 1.08 x 1.08 = $11,664,000.
Present value calculated based on the original effective interest rate
= $11,664,000 / (1.07 x1.07) = $10,187,789.

($10,187,789 + $500,000 - $10,000,000) / $10,000,000 = 6.88%.

Because the difference is within the “10 per cent test”, the existing bank loan A will not be derecognised.

$500,000 transaction cost will be adjusted to the carrying amount of the bank loan and amortised over two years up to 31 January 2015.

Answer 4(c)

Bank loan B is accounted for as an extinguishment of liability.

Carrying amount of principal at 1 April 2013 = $8,000,000

Interest accrual: $8,000,000 x 6.75% x 0.5 year = $270,000

Early repayment penalty: $6,000,000 x 1% = $60,000

Total amount to be paid for early settlement = $8,330,000

* * * END OF EXAMINATION PAPER * * *