AIA P13 May 2013

Denmarc, a public limited company, is a pharmaceutical manufacturer. The entity's draft statements of financial position as at 30 April 2013 are as follows:

	Denmarc	Kenz	Zenu
	$m	$m	$m
Assets			
Non-current assets			
Property, plant and equipment	673	1,053	806
Investment in subsidiaries	1,669		
Financial assets	140	13	27
	2,482	1,066	833
Current assets	1,294	1,015	455
TOTAL ASSETS	3,776	2,081	1,288
Equity and liabilities			
Equity			
Share capital	1,456	783	507
Retained earnings	1,386	575	220
Other components of equity	78	48	59
Total equity	2,920	1,406	786
Liabilities			
Non-current liabilities	592	420	95
Current liabilities	264	255	407
Total liabilities	856	675	502
TOTAL EQUITY AND LIABILITIES	3,776	2,081	1,288

The following information is relevant to the preparation of the group financial statements of Denmarc:

(i) On 1 May 2012, Denmarc paid $780 million cash to acquire a controlling interest in Kenz, a public limited company, by acquiring 67% of the entity's share capital. The following financial data refers to Kenz at acquisition:

	$m
• fair value of identifiable net assets	1,216
• retained earnings	389
• other components of equity	34
• fair value of non-controlling interest	514

Denmarc wishes to use the 'full goodwill' method in the preparation of its group financial statements. Any excess in fair value is due to non-depreciable land.

On 30 April 2013, Denmarc paid $184 million cash to acquire a further 11% interest in the share capital of Kenz. There have been no other events affecting the share capital of Kenz.

Following the further acquisition on 30 April 2013, goodwill was tested for impairment. The recoverable amount of Kenz was $1,430 million. No adjustment for this has yet been made in any of the above financial statements.

(ii) On 1 May 2012 Denmarc acquired 100% of the equity interest of Zenu, a limited company. Denmarc has calculated the total consideration transferred to be $705 million, as follows:

	$m
Cash	643
Carrying value of non-depreciable land transferred to:	
Zenu	24
Former owners of Zenu	26
Acquisition costs	12
	705

Both parcels of land had a fair value of $35 million at the date of acquisition. The sale price of $35 million in respect of the land transferred to the former owners of Zenu has been debited to trade receivables and credited to retained earnings. No other entries have been made in the financial statements concerning either parcel of land. As part of the above arrangement, Denmarc also agreed to pay a further $40 million cash to the former owners of Zenu contingent upon the approval of a licence for a new medicine. There was no significant difference in the fair value of this obligation at 30 April 2013. At the date of acquisition, Zenu's retained earnings were $117 million, other components of equity were $55 million and share capital was $507 million. The fair value of Zenu's identifiable net assets was not significantly different to carrying value. No goodwill impairment was necessary as at 30 April 2013.

(iii) Included in Denmarc's property, plant and equipment is a research plant with a carrying value of $50 million. Denmarc is required by legislation to dismantle the plant at the end of its useful life and has therefore built up a dismantling provision of $10 million in its financial statements. On 30 April 2013 another pharmaceutical company offered to buy the plant for $47 million. The offer includes taking over responsibility for the dismantling of the plant. Denmarc has estimated that the present value of the estimated cash flows from the plant's continued use by the group is $55 million.

(iv) Included in the financial assets of Denmarc is a portfolio of 5% loans. The portfolio's effective rate of interest is 10%. Denmarc has adopted IFRS 9 Financial Instruments and the portfolio is included at its amortised cost carrying value of $118 million. On 30 April 2013 Denmarc granted a concession to the borrowers which requires an immediate payment of $14 million followed by two payments of $50 million at the end of each of the next two years. The effective interest rate under the concession is 9.3% and the current market interest rate is 10.7%.

(v) In an attempt to boost sales of one of its new products, on 1 May 2012 Denmarc appointed 100 employees on fixed three-year contracts. The starting salary for each employee is $200,000 per annum. It is estimated that salaries will rise by 8% per annum. Denmarc agreed to pay each employee a retirement benefit of 10% of final salary per annum for each year of the contractual period. Denmarc's entity-specific credit risk is 7%. The yield on AA-rated corporate bonds of a term and currency consistent with the obligation is 5%. No entries have been made in the financial statements apart from the recording of salary payments for the current year.

Required

a) Prepare the Denmarc group statement of financial position as at 30 April 2013 in accordance with International Financial Reporting Standards (IFRS).
[35 marks]

b) The directors of Denmarc have been discussing the financial asset referred to in note (iv) above and now plan to value the loan at its fair value in next year's financial statements. They believe future market interest rates are set to fall and that the resulting increase in the loan's fair value will have two beneficial impacts: 1) any increase will be included in profits which will enhance the group's performance figures and 2) parts or all of the asset could be sold if necessary to fund future capital expenditure.

Required

Advise the directors of Denmarc on whether their future plan to value the loan at fair value is both ethically acceptable and available under IFRS.

[5 marks]
(Total 40 marks)