Section A – THIS ONE question is compulsory and MUST be attempted

1 The following draft financial statements relate to Marchant, a public limited company.

Marchant Group: Draft statements of profit or loss and other comprehensive income for the year ended 30 April 2014.

	Marchant	Nathan	Option
	$m	$m	$m
Revenue	400	115	70
Cost of sales	(312)	(65)	(36)
Gross profit	88	50	34
Other income	21	7	2
Administrative costs	(15)	(9)	(12)
Other expenses	(35)	(19)	(8)
Operating profit	59	29	16
Finance costs	(5)	(6)	(4)
Finance income	6	5	8
Profit before tax	60	28	20
Income tax expense	(19)	(9)	(5)
Profit for the year	41	19	15
Other comprehensive income – revaluation surplus	10		
Total comprehensive income for year	51	19	15

The following information is relevant to the preparation of the group statement of profit or loss and other comprehensive income:

1. On 1 May 2012, Marchant acquired 60% of the equity interests of Nathan, a public limited company. The purchase consideration comprised cash of $80 million and the fair value of the identifiable net assets acquired was $110 million at that date. The fair value of the non-controlling interest (NCI) in Nathan was $45 million on 1 May 2012. Marchant wishes to use the 'full goodwill' method for all acquisitions. The share capital and retained earnings of Nathan were $25 million and $65 million respectively and other components of equity were $6 million at the date of acquisition. The excess of the fair value of the identifiable net assets at acquisition is due to non-depreciable land.

   Goodwill has been impairment tested annually and as at 30 April 2013 had reduced in value by 20%. However at 30 April 2014, the impairment of goodwill had reversed and goodwill was valued at $2 million above its original value. This upward change in value has already been included in above draft financial statements of Marchant prior to the preparation of the group accounts.

2. Marchant disposed of an 8% equity interest in Nathan on 30 April 2014 for a cash consideration of $18 million and had accounted for the gain or loss in other income. The carrying value of the net assets of Nathan at 30 April 2014 was $120 million before any adjustments on consolidation. Marchant accounts for investments in subsidiaries using IFRS 9 *Financial Instruments* and has made an election to show gains and losses in other comprehensive income. The carrying value of the investment in Nathan was $90 million at 30 April 2013 and $95 million at 30 April 2014 before the disposal of the equity interest.

3. Marchant acquired 60% of the equity interests of Option, a public limited company, on 30 April 2012. The purchase consideration was cash of $70 million. Option's identifiable net assets were fair valued at $86 million and the NCI had a fair value of $28 million at that date. On 1 November 2013, Marchant disposed of a 40% equity interest in Option for a consideration of $50 million. Option's identifiable net assets were $90 million and the value of the NCI was $34 million at the date of disposal. The remaining equity interest was fair valued at $40 million. After the disposal, Marchant exerts significant influence. Any increase in net assets since acquisition has been reported in profit or loss and the carrying value of the investment in Option had not changed since acquisition. Goodwill had been impairment tested and no impairment was required. No entries had been made in the financial statements of Marchant for this transaction other than for cash received.

4. Marchant sold inventory to Nathan for $12 million at fair value. Marchant made a loss on the transaction of $2 million and Nathan still holds $8 million in inventory at the year end.

5. The following information relates to Marchant's pension scheme:

	$m
Plan assets at 1 May 2013	48
Defined benefit obligation at 1 May 2013	50
Service cost for year ended 30 April 2014	4
Discount rate at 1 May 2013	10%
Re-measurement loss in year ended 30 April 2014	2
Past service cost 1 May 2013	3

   The pension costs have not been accounted for in total comprehensive income.

6. On 1 May 2012, Marchant purchased an item of property, plant and equipment for $12 million and this is being depreciated using the straight line basis over 10 years with a zero residual value. At 30 April 2013, the asset was revalued to $13 million but at 30 April 2014, the value of the asset had fallen to $7 million. Marchant uses the revaluation model to value its non-current assets. The effect of the revaluation at 30 April 2014 had not been taken into account in total comprehensive income but depreciation for the year had been charged.

7. On 1 May 2012, Marchant made an award of 8,000 share options to each of its seven directors. The condition attached to the award is that the directors must remain employed by Marchant for three years. The fair value of each option at the grant date was $100 and the fair value of each option at 30 April 2014 was $110. At 30 April 2013, it was estimated that three directors would leave before the end of three years. Due to an economic downturn, the estimate of directors who were going to leave was revised to one director at 30 April 2014. The expense for the year as regards the share options had not been included in profit or loss for the current year and no directors had left by 30 April 2014.

8. A loss on an effective cash flow hedge of Nathan of $3 million has been included in the subsidiary's finance costs.

9. Ignore the taxation effects of the above adjustments unless specified. Any expense adjustments should be amended in other expenses.

Required:

(a) (i) Prepare a consolidated statement of profit or loss and other comprehensive income for the year ended 30 April 2014 for the Marchant Group. (30 marks)

(ii) Explain, with suitable calculations, how the sale of the 8% interest in Nathan should be dealt with in the group statement of financial position at 30 April 2014. (5 marks)

(b) The directors of Marchant have strong views on the usefulness of the financial statements after their move to International Financial Reporting Standards (IFRSs). They feel that IFRSs implement a fair value model. Nevertheless, they are of the opinion that IFRSs are failing users of financial statements as they do not reflect the financial value of an entity.

Required:

Discuss the directors' views above as regards the use of fair value in IFRSs and the fact that IFRSs do not reflect the financial value of an entity. (9 marks)