PROFESSIONAL LEVEL EXAMINATION

MONDAY 9 DECEMBER 2013

(3 hours)

FINANCIAL ACCOUNTING AND REPORTING

This paper consists of **FOUR** written test questions (100 marks).

1. Ensure your candidate details are on the front of your answer booklet.
2. Answer each question in black ball point pen only.
3. Answers to each written test question must begin on a new page and must be clearly numbered. Use both sides of the paper in your answer booklet.
4. The examiner will take account of the way in which answers are presented.

Unless otherwise stated, make all calculations to the nearest month and the nearest £.

All references to IFRS are to International Financial Reporting Standards and International Accounting Standards.

IMPORTANT Question papers contain confidential information and must NOT be removed from the examination hall. **DO NOT TURN OVER UNTIL YOU ARE INSTRUCTED TO BEGIN WORK**	You MUST enter your candidate number in this box.

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1. Dedlock Ltd is an IT company. Until the current year it operated solely as a service company providing programming and testing services for its clients. In March 2013 Dedlock Ltd expanded its operations by manufacturing high-spec laptops, buying in components from other UK companies.

Richard, the finance director, who is an ICAEW Chartered Accountant, has produced draft financial statements for the year ended 30 June 2013. However, the managing director has some concerns about these financial statements as he knows that Richard is due to retire shortly and plans to sell his shares in the company. The managing director is concerned that Richard's treatment of certain matters has been influenced by Richard's desire to make the company's financial statements appear more attractive, so that he may get a better price for his shares.

The managing director has asked Clara, an ICAEW Chartered Accountant sole practitioner, to redraft these financial statements. Clara has had an initial meeting with Richard, who has hinted that if she makes as few adjustments to the financial statements as possible, he will recommend her as his replacement.

The draft financial statements, as prepared by Richard, are set out below.

Draft statement of financial position as at 30 June 2013

	£	£
ASSETS		
Non-current assets		
Property, plant and equipment (Notes 1 and 2)		567,800
Current assets		
Inventories	278,500	
Trade and other receivables (Note 3)	105,200	
Cash and cash equivalents	15,800	
		399,500
Total assets		**967,300**
EQUITY AND LIABILITIES		
Equity		
Ordinary share capital (£1 shares)		200,000
Preference share capital (Note 4)		100,000
Share premium		75,000
Retained earnings		484,100
		859,100
Current liabilities		
Trade and other payables	82,200	
Taxation (Note 5)	26,000	
		108,200
Total equity and liabilities		**967,300**

Draft income statement for the year ended 30 June 2013

	£
Revenue	2,876,500
Cost of sales	(1,980,900)
Gross profit	895,600
Administrative expenses	(579,200)
Other operating costs	(185,300)
Profit before tax	131,100
Income tax (Note 5)	(26,000)
Profit for the year	105,100

The following matters have been identified by the managing director for Clara's consideration:

(1) On 1 July 2012 Dedlock Ltd received a government grant of £10,000 to help finance the acquisition of a machine, purchased on the same date for £25,000. The machine has been depreciated on a reducing balance basis using a rate of 20% pa. Richard has credited the £10,000 grant received to revenue in the income statement. Clara has discussed this matter with the managing director and they have agreed that Dedlock Ltd's accounting policy for government grants will be to use the deferred income method. Depreciation on plant and machinery is presented in cost of sales.

(2) On 30 June 2013, the directors decided to sell a machine which had cost Dedlock Ltd £20,000. Richard did not adjust the financial statements to reflect this decision on the grounds that the machine had not been sold during the year. Accumulated depreciation on this machine at 30 June 2013 is £8,500. The machine is expected to sell for £8,000 with selling costs of £450 and the directors are confident that a buyer will be found by the end of December 2013.

(3) In August 2013, when the financial statements were drafted, Richard became aware that one of Dedlock Ltd's customers, Fastolfe Ltd, had gone into liquidation. Dedlock Ltd's trade receivables at 30 June 2013 include £55,700 due from Fastolfe Ltd. Correspondence from the liquidator indicates that this debt will not be paid. Richard has not made any allowance against this debt as Fastolfe Ltd's financial difficulties had not been known at the year end. Dedlock Ltd's managing director also believes that an allowance of 2% should be made against all other trade receivables. Dedlock Ltd presents any expenses in relation to irrecoverable debts or movements on allowances in other operating costs.

(4) On 1 January 2013 Dedlock Ltd issued 200,000 irredeemable preference shares at par, included in equity above. These shares have a nominal value of 50p each and carry a coupon rate of 5% pa. The payment of the dividend is mandatory and if it is unpaid at the end of a period it becomes cumulative the following period. The dividend due was paid on 30 June 2013 and is shown in the statement of changes in equity for the year ended 30 June 2013.

(5) Richard has correctly calculated the income tax liability for the year ended 30 June 2013 at £26,000. However, included in revenue in the income statement is an amount of £3,175, which was the amount of the income tax liability at 30 June 2012 which did not ultimately need to be paid.

(6) Laptop sales commenced on 1 April 2013. All laptops were sold with a two year warranty under which Dedlock Ltd will repair or replace the faulty product at no cost to the customer. At the date that the financial statements were drafted, no laptops had been returned as faulty and therefore Richard made no provision in respect of the warranties provided. The managing director estimates that 5% of all laptops will be returned. Out of all laptops returned, half will be repaired, at an average cost to Dedlock Ltd of £190 per laptop. The remaining laptops will have to be replaced. From April to June 2013 Dedlock Ltd sold 1,000 laptops, generating revenue of £600,000 and making a gross profit of 20%. (Assume that all returns from laptop sales in the year ended 30 June 2013 are made on 30 June 2014.)

(7) On 15 June 2013 Dedlock Ltd took delivery of a large order of stationery supplies. The purchase invoice amounted to £5,300, but was not received until July 2013. Richard has not made any adjustment for this invoice.

Dedlock Ltd uses a discount rate of 7% pa where necessary to reflect the time value of money in the preparation of the financial statements.

Requirements

(a) Prepare a revised income statement for Dedlock Ltd for the year ended 30 June 2013 and a revised statement of financial position as at that date, in a form suitable for publication. Notes to the financial statements are **not** required. **(20 marks)**

(b) Identify and explain any ethical issues arising for Clara and Richard and any action that Clara should take. **(4 marks)**

(c) Identify those elements of the financial statements, as set out in the IASB's Conceptual Framework, which are relevant to the statement of financial position. Explain how these are relevant to the treatment of the irredeemable preference shares and the warranty provision above. **(6 marks)**

(30 marks)

2. On 1 July 2012 Chuzzlewit plc had a number of subsidiary companies, and one associated company, all of which it acquired several years ago. An extract from the group's consolidated income statement for the year ended 30 June 2013 and the consolidated statement of financial position as at that date are set out below.

Consolidated income statement for the year ended 30 June 2013 (extract)

	£
Continuing operations	
Profit from operations	578,400
Finance costs	(45,500)
Share of profits of associate	102,800
Profit before tax	635,700
Income tax expense	(128,000)
Profit for the year from continuing operations	507,700
Discontinued operations	
Profit for the year from discontinued operations	98,500
Profit for the year	606,200
Attributable to:	
Owners of Chuzzlewit plc	510,300
Non-controlling interest	95,900
	606,200

Consolidated statement of financial position as at 30 June

	2013 £	2012 £
ASSETS		
Non-current assets		
Property, plant and equipment	1,746,600	1,549,000
Investment in associate	285,900	287,800
Intangibles	203,000	289,500
	2,235,500	2,126,300
Current assets		
Inventories	292,900	198,100
Trade and other receivables	151,800	177,800
Cash and cash equivalents	41,500	31,500
	486,200	407,400
Total assets	**2,721,700**	**2,533,700**
EQUITY AND LIABILITIES		
Equity		
Ordinary share capital (50p shares)	450,000	300,000
Share premium account	90,000	40,000
Retained earnings	1,435,000	1,326,100
Attributable to the equity holders of Chuzzlewit plc	1,975,000	1,666,100
Non-controlling interest	279,200	301,800
	2,254,200	1,967,900
Non-current liabilities		
Bank loan	250,000	300,000
Current liabilities		
Trade and other payables	82,500	105,800
Income tax payable	135,000	160,000
	217,500	265,800
Total equity and liabilities	**2,721,700**	**2,533,700**

Additional information:

(1) On 1 January 2013 Chuzzlewit plc sold all of its 70% holding in one of its subsidiaries, Gradgrind Ltd, for a cash sum. Goodwill arising on the acquisition of Gradgrind Ltd was calculated at £56,000, using the proportionate method, although £10,000 of this amount had been written off by 30 June 2012. The remaining movement on intangibles relates to impairment write-offs with respect to goodwill arising on the acquisition of other subsidiaries. The profit from discontinued operations in the consolidated income statement above relates wholly to the sale of the shares in Gradgrind Ltd and can be analysed as follows:

	£
Profit before tax	82,300
Income tax expense	(4,400)
Profit on disposal	20,600
	98,500

The net assets of Gradgrind Ltd at the date of disposal were as follows:

	£
Property, plant and equipment	314,000
Inventories	56,400
Trade and other receivables	26,800
Cash and cash equivalents	3,500
Trade and other payables	(12,200)
	388,500

(2) Consolidated trade and other payables include £2,200 (2012: £3,100) of unpaid interest due on the bank loan.

(3) Depreciation of £351,600 was recognised during the year ended 30 June 2013. In addition to the property, plant and equipment disposed of through the sale of Gradgrind Ltd, plant with a carrying amount of £102,000 was sold for cash of £117,000.

(4) On 1 October 2012 Chuzzlewit plc issued 100,000 ordinary shares for cash. This was followed by a bonus issue on 1 January 2013, utilising the share premium account.

(5) All group companies paid ordinary dividends during the year.

Requirement

Prepare a consolidated statement of cash flows for Chuzzlewit plc for the year ended 30 June 2013, including a note reconciling profit before tax to cash generated from operations, using the indirect method. A note showing the effects of the disposal of Gradgrind Ltd is **not** required. **(17 marks)**

3. Nickleby plc is a UK listed company. Draft financial statements for the year ended 30 June 2013 have been prepared by the financial controller, but the following outstanding issues have been identified:

(1) On 1 July 2012 Nickleby plc entered into a non-cancellable lease for a specialised machine. The machine has a list price of £17,500. Lease payments comprise a total of £20,000, payable by an initial deposit of £4,000 on 1 July 2012, followed by four annual instalments of £4,000, the first of which was paid on 30 June 2013. The financial controller debited the total amount paid during the year of £8,000 to cost of sales. The machine has a useful life of four years, and Nickleby plc is responsible for the maintenance and insurance of the machine during the lease term. The interest rate implicit in the agreement is 15% pa.

(2) On 1 January 2013 Nickleby plc borrowed £500,000 at an interest rate of 5% pa, solely to finance the construction of a new building. Work on the building started on 1 January 2013, and the building is expected to take 12 months to complete. During the six months to 30 June 2013 interest income of £5,400 was earned on surplus funds invested. The financial controller credited the interest earned to other income and debited interest paid to finance costs.

(3) In May 2013 Nickleby plc began to deal with an overseas supplier for the first time. A purchase order was placed on 1 June 2013, and a delivery of goods was made to Nickleby plc on 10 June 2013. An invoice was received by Nickleby plc for €101,000 on 10 July 2013. Nickleby plc had sold all the goods by 30 June 2013 but no accounting entries had been made to recognise the outstanding payment as the invoice was not received until after the year end.

Spot exchange rates were as follows:

1 June 2013	€1: £0.80
10 June 2013	€1: £0.82
30 June 2013	€1: £0.75
10 July 2013	€1: £0.73

(4) Nickleby plc measures all of its assets under the revaluation model and undertakes regular valuations. On 1 July 2012 an independent professional valuation of all Nickleby plc's property, plant and equipment was carried out, which has not yet been incorporated into the financial statements. Depreciation for the year ended 30 June 2013 has not yet been recognised. Depreciation on buildings is presented in administrative expenses, and depreciation on plant and machinery is presented in cost of sales. Relevant details are as follows:

	Carrying amount at 1 July 2012	**Fair value at 1 July 2012**	**Estimated remaining useful life at 1 July 2012**	**Annual depreciation charge based on historic cost**
	£	**£**		**£**
Land	800,000	1,000,000	–	–
Buildings	1,906,000	2,500,000	40 years	21,500
Plant and machinery	815,700	450,000	4 years	121,300

The revaluation surplus contains £150,400 in respect of previous revaluations of plant and machinery. The fall in value of the plant and machinery is due to a consumption of economic benefits. Nickleby plc makes annual transfers between the revaluation surplus and retained earnings.

Requirements

(a) Explain the required IFRS financial reporting treatment of the four issues above in the financial statements for the year ended 30 June 2013, preparing all relevant calculations and setting out the required adjustments in the form of journal entries. **(26 marks)**

(b) Explain any differences between IFRS and UK GAAP in respect of the financial reporting treatment of all of the above issues. **(5 marks)**

(31 marks)

NOTES: Ignore the impact of taxation on the above issues.
The preparation of disclosure notes is not required.

4. Cratchit plc has investments in two companies, Drummle Ltd and Gargery Ltd. The newly-appointed assistant accountant has prepared a draft consolidated statement of financial position as at 30 June 2013, by simply adding together each line of the individual statements of financial position of the three companies.

This draft consolidated statement of financial position is shown below, together with the individual statements of financial position of Drummle Ltd and Gargery Ltd:

	Cratchit plc group (draft consolidated) £	Drummle Ltd £	Gargery Ltd £
ASSETS			
Non-current assets			
Property, plant and equipment	1,697,700	539,300	377,500
Goodwill (Note (2))	50,000	50,000	–
Investment in Drummle Ltd	400,000	–	–
Investment in Gargery Ltd	150,000	–	–
	2,297,700	589,300	377,500
Current assets			
Inventories	770,900	178,900	246,400
Trade and other receivables	293,000	87,800	99,300
Cash and cash equivalents	23,800	1,700	800
	1,087,700	268,400	346,500
Total assets	**3,385,400**	**857,700**	**724,000**
EQUITY AND LIABILITIES			
Equity			
Ordinary share capital (£1 shares)	1,000,000	300,000	200,000
Revaluation surplus	400,000	150,000	–
Retained earnings	1,441,200	224,900	365,600
	2,841,200	674,900	565,600
Current liabilities			
Trade and other payables	315,200	111,800	97,400
Taxation	229,000	71,000	61,000
	544,200	182,800	158,400
Total equity and liabilities	**3,385,400**	**857,700**	**724,000**

Additional information:

(1) Cratchit plc acquired 240,000 shares in Drummle Ltd on 1 July 2012, when the retained earnings of Drummle Ltd were £108,000. The consideration was made up of £400,000 in cash, paid on 1 July 2012, and 200,000 shares in Cratchit plc which were issued on 1 July 2013. At the date of acquisition, the market value of each Cratchit plc share was £1.20 but this had risen to £1.40 by 30 June 2013. No accounting entries have yet been made for the shares which were issued on 1 July 2013.

The fair values of the assets, liabilities and contingent liabilities of Drummle Ltd at the date of acquisition by Cratchit plc were equal to their carrying amounts except for a contingent liability disclosed in the notes to Drummle Ltd's financial statements for the year ended 30 June 2012, which had a fair value of £20,000. The fair value of the contingent liability had not changed by 30 June 2013.

(2) Drummle Ltd's statement of financial position as at 30 June 2012 included goodwill of £60,000, which had arisen on the acquisition of the business of a sole trader. At 30 June 2013 the same goodwill was included in Drummle Ltd's statement of financial position at £50,000, due to an impairment of £10,000 having been charged in the current year.

(3) Cratchit plc acquired 80,000 shares in Gargery Ltd for £150,000 cash on 1 January 2013. Gargery Ltd has made a loss since acquisition of £22,500. The fair values of the assets, liabilities and contingent liabilities of Gargery Ltd at the date of acquisition by Cratchit plc were equal to their carrying amounts, with the exception of a machine which had a fair value £35,000 in excess of its carrying amount. The machine had a remaining useful life of five years on 1 January 2013. No fair value adjustment has been made in the books of Gargery Ltd.

(4) No shares have been issued by Drummle Ltd or Gargery Ltd since Cratchit plc acquired its shares in those companies. All revaluation surpluses arose prior to the formation of the Cratchit group.

(5) On 31 May 2013 Cratchit plc purchased goods to the value of £60,000 from Gargery Ltd. Gargery Ltd had charged a 20% mark up on these goods. These goods were still in Cratchit plc's inventory at the year end.

(6) At 30 June 2013 Cratchit plc's trade receivables included £25,600 due from Drummle Ltd. Drummle Ltd's trade payables included only £18,700 due to Cratchit plc. The difference was due to cash in transit.

(7) An impairment loss in respect of goodwill arising on the acquisition of Drummle Ltd of £20,000 was identified at 30 June 2013 and needs to be recognised. There has been no impairment in the carrying amount of Cratchit plc's investment in Gargery Ltd. Cratchit plc prefers to measure goodwill and the non-controlling interest using the proportionate method.

Requirements

(a) Prepare a revised consolidated statement of financial position for Cratchit plc as at 30 June 2013. **(17 marks)**

(b) With reference to the acquisition of Drummle Ltd, and using calculations where appropriate, explain and justify the two methods of calculating goodwill and the non-controlling interest allowed by IFRS 3, Business Combinations. You should assume that the fair value of the non-controlling interest in Drummle Ltd at 1 July 2012 was £100,000. **(5 marks)**

(22 marks)

MARK PLAN AND EXAMINER'S COMMENTARY

The marking plan set out below was that used to mark this question. Markers were encouraged to use discretion and to award partial marks where a point was either not explained fully or made by implication. More marks were available than could be awarded for each requirement. This allowed credit to be given for a variety of valid points which were made by candidates.

Question 1

Overall marks for this question can be analysed as follows: **Total: 30**

General comments

Part (a) of this question required candidates to revise a draft income statement and statement of financial position for a number of adjustments. The amendments were in relation to the receipt of a government grant, a held for sale asset, the recoverability of receivables, irredeemable preference shares and dividend thereon, an adjusting subsequent event, an overprovision of income tax from the previous year, a provision for warranty costs and an accrual. Part (b) required an explanation of any ethical issues arising from the scenario and the action to be taken. Part (c) required candidates to identify and describe the elements of the financial statements which are relevant to the statement of financial position, with reference to the treatment of the irredeemable preference shares and the provision.

Dedlock Ltd

(a) Revised financial statements

Statement of financial position as at 30 June 2013

	£	£
ASSETS		
Non-current assets		
Property, plant and equipment (567,800 – (20,000 – 8,500))		556,300
Current assets		
Inventories	278,500	
Trade and other receivables (105,200 – 55,700 – 990 (W2))	48,510	
Cash and cash equivalents	15,800	
	342,810	
Non-current asset held for sale	7,550	
		350,360
Total assets		906,660
Equity		
Ordinary share capital	200,000	
Share premium	75,000	
Retained earnings (W1)	394,506	
Equity		669,506
Non-current liabilities		
Preference share capital (irredeemable)	100,000	
Deferred income (W3)	6,400	
		106,400
Current liabilities		
Trade and other payables (82,200 + 5,300)	87,500	
Deferred income (W3)	1,600	
Provisions (W4)	15,654	
Taxation	26,000	
		130,754
Total equity and liabilities		906,660

Income statement for the year ended 30 June 2013

	£
Revenue (2,876,500 – 10,000 – 3,175)	2,863,325
Cost of sales (W2)	(1,998,504)
Gross profit	864,821
Administrative expenses (W2)	(584,500)
Other operating costs (W2)	(241,990)
Operating profit	38,331
Finance costs (200,000 x 50p x 5% x 6/12)	(2,500)
Profit before tax	35,831
Income tax (26,000 – 3,175)	(22,825)
Profit for the year	13,006

Workings

(1) Retained earnings

	£
Per draft	484,100
Less Draft profit for the year	(105,100)
Add Revised profit for the year	13,006
Add back finance costs from SCE (already taken off as dividend)	2,500
	394,506

(2) Expenses

	Cost of sales	*Other operating costs*	*Admin expenses*
	£	£	£
Per draft	1,980,900	185,300	579,200
Government grant (W3)	(2,000)		
Loss on held for sale asset (11,500 – (8,000 – 450))	3,950		
Bad debt written off		55,700	
Bad debt allowance ((105,200 – 55,700) x 2%)		990	
Warranty provision (W4)	15,654		
Accrual			5,300
	1,998,504	241,990	584,500

Note: Marks were awarded if items were included in different line items in the income statement provided that the heading used was appropriate.

(3) Government grant

	£
Grant as received	10,000
Taken to cost of sales y/e 30 June 2013 x 20% =	(2,000)
At 30 June 2013	8,000
Within one year x 20% =	(1,600)
After one year (β)	6,400

(4) Warranty provision

Number to repair or replace = 1,000 x 5% x ½ = 25

	£
Repaired (25 x £190)/1.07	4,439
Replaced (600,000/1,000 = £600 x 25 x 80%)/1.07	11,215
	15,654

Tutorial note

Credit was also given if candidates stated that general provisions are not allowed in respect of receivables (IAS 39).

Candidates generally performed well on this part of the question. Presentation of the two statements was generally of a sufficient standard to collect the presentation marks. Candidates should ensure they transfer their figures into final totals for individual line items in the financial statements.

The majority of candidates identified that there was a non-current asset held for sale and that it should be separately analysed, although a small minority thought that it should still be considered to be a non-current asset. Of those candidates who correctly identified that it should be presented as part of current assets, only a minority presented it separately from current assets generally. A good number of candidates correctly calculated the relevant figure in both statements.

The two adjustments to trade receivables for bad and doubtful debts were generally dealt with correctly, with almost all candidates correctly deducting the amount for the customer who had gone into liquidation before calculating the closing allowance. However, a worrying number of candidates presented the closing allowance as a liability in the statement of financial position, as opposed to netting it off trade and other receivables. Property, plant and equipment was stated correctly by a much smaller number of candidates, with various different adjustments being made to the draft figure.

The classification and valuation of the preference shares proved a particular challenge. A number of candidates treated this as equity or as a hybrid financial instrument, split between non-current liabilities and equity. Some even treated this as equity but then went on in Part (b) of the question to state that it should be treated as a liability. The related finance costs also caused a significant number of candidates an issue, with only a minority getting the correct figure in the income statement and even less going on to add this figure back to the profit figure. Where the adjustment was made to retained profits it was more often than deducted, instead of being added.

Deferred income in respect of grants of £8,000 was correctly calculated by the majority of candidates, although the split between current and non-current liabilities was often incorrect and sometimes the adjustment in the income statement was omitted or incorrectly added to expenses, instead of being deducted.

The most common error was to reduce revenue by only the deferred part of the grant, instead of recognising that the whole grant needed to be removed from revenue and dealt with either as other income or offset to cost of sales. Weaker candidates tried to apply the netting off method to the grant and make depreciation adjustments for the asset.

Although the income statement figure for taxation was usually correct, some candidates also showed this figure as the closing liability, ignoring the overprovision from the previous year.

The warranty provision caused most candidates a problem. Where candidates did attempt a calculation the figure for the repaired element was usually correct. However, the figure for the replaced element was only calculated correctly by a minority of candidates (the most common error being not taking into account the profit margin on the goods under warranty when they were expected to be replaced). Even fewer candidates then went on to discount the total. A significant number of candidates went on to deduct their calculated warranty provision from revenue rather than showing it (separately) as a current liability.

Total possible marks Maximum full marks	21½ 20

(b) Ethical issues

Richard has omitted to adjust for a number of issues, all of which could be said to have a negative effect on Dedlock Ltd's financial statements for the year. The correct treatment of the overprovision of last year's income tax charge reduces revenue, the reclassification of the irredeemable preference shares increases debt and all of the other adjustments reduce the profit for the year. Profit for the year before the adjustments was £105,100. However, after adjustments it has fallen by 80%, to £13,006.

Richard is the finance director of the company, and these are all matters of which he was, or should have been, generally aware. This calls into question whether Richard has failed to make these adjustments as he is influenced by the fact that he may get a better price for his shares if the company's profit is higher, and its debt lower. This is a self-interest threat and calls Richard's integrity into question.

Alternatively, if it is that Richard does not understand *how* to make these adjustments, or that these adjustments were necessary, then that calls his professional competence into question. ICAEW Chartered accountants have an obligation to maintain their continuing professional development and they should ensure that their technical knowledge and professional skills are kept up to date.

Clara faces a number of ethical issues, not least the question of whether the mistakes were deliberate or a lack of knowledge on Richard's part. Clara also faces a self-interest threat as she may be offered a permanent position at Dedlock Ltd if she "turns a blind eye" to Richard's failings.

Clara should ignore the possibility of self-interest and discuss the adjustments with Richard and remind him of his professional responsibilities to ensure that accounting standards are correctly followed.

Amendments must be made to the financial statements and if Richard refuses to make them, Clara must discuss the matter with the managing director.

If Richard continues to try to dominate and exert influence on Clara then it would be appropriate for Clara to consult the ICAEW ethical handbook and discuss the matter with the ICAEW confidential helpline.

Almost all candidates made a reasonable attempt at this part of the question, with a good number obtaining full marks. Candidates should remember that to gain the most marks their answer should be tailored to the question scenario. Most candidates correctly identified that there was a self-interest threat for both Richard and Clara, explained how these threats arose and suggested appropriate courses of action. A minority of candidates answered as if Clara was an external auditor, as opposed to an independent consultant. A few felt there were money laundering issues at play.

Total possible marks	8½
Maximum full marks	4

(c) Elements of financial statements, irredeemable preference shares and warranty provision

The three elements of financial statements relevant to the statement of financial position are assets, liabilities and equity.

Irredeemable preference shares

IAS 32 classifies financial instruments as financial assets, financial liabilities or equity.

The irredeemable preference shares are an example of a (financial) liability. Although the irredeemable preference shares take the legal form of equity they are liabilities in substance as they include contractual obligations to transfer economic benefits to the holder (fixed preference (ie preferential) dividends). They arise from a past event (the issue of the shares

Warranty provision

A provision is a liability of uncertain timing or amount and should be recognised if there is a present obligation from a past event, it is probable that an outflow of economic benefits will be needed to settle the obligation and that a reliable estimate can be made of that amount.

If one or more of these requirements are not met then a provision should not be recognised as it is not a liability.

Probable means that it is more likely than not to occur or >50%. If it is not probable that an outflow of economic benefits will be needed to settle the obligation or the amount of the settlement cannot be measured reliably then it does not meet the definition of a liability and instead the amount may need to be disclosed as a contingent liability.

In conclusion, Dedlock Ltd has a present obligation (its contractual obligation to repair or replace any faulty products under a two year warranty), as a result of past events (the sale of the goods). There is a probable outflow and a reliable estimate can be made (based on the number and amount of past claims under warranties). The estimation of the amount of the liability is made using expected values. Richard should therefore have recognised a provision as a liability exists.

Answers to this part of the question were very mixed, with only a minority of candidates showing a good understanding of the elements of financial statements. Far too many candidates reproduced text from the open book, which was not required. A significant number of candidates instead discussed the qualitative characteristics of financial information, which gained no marks. Others did write about the elements of financial statements, but failed to relate these to the preference shares and warranty provision.

Total possible marks	8½
Maximum full marks	6

Question 2

Overall marks for this question can be analysed as follows: **Total: 17**

General comments
This question tested the preparation of a consolidated statement of cash flows and supporting reconciliation note, where a subsidiary had been disposed of during the year. Missing figures to be calculated included dividends paid (to the group and to the non-controlling interest), dividends received, tax paid, additions to property, plant and equipment, and proceeds from the issue of share capital.

Chuzzlewit plc

Consolidated statement of cash flows for the year ended 31 December 2012

	£	£
Cash flows from operating activities		
Cash generated from operations (Note)	875,600	
Interest paid (W2)	(46,400)	
Income tax paid (W3)	(157,400)	
Net cash from operating activities		671,800
Cash flows from investing activities		
Purchase of property, plant and equipment (W4)	(965,200)	
Proceeds from sale of property, plant and equipment	117,000	
Dividends received from associate (W5)	104,700	
Disposal of Gradgrind Ltd net of cash disposed of (W1)	335,050	
Net cash used in investing activities		(408,450)
Cash flows from financing activities		
Proceeds from share issues (W6)	200,000	
Repayment of long-term loan (300,000 – 250,000)	(50,000)	
Dividends paid (W8)	(401,400)	
Dividends paid to non-controlling interest (W9)	(1,950)	
Net cash used in financing activities		(253,350)
Net increase in cash and cash equivalents		10,000
Cash and cash equivalents at beginning of period		31,500
Cash and cash equivalents at end of period		41,500

Note: Reconciliation of profit before tax to cash generated from operations

	£
Profit before tax (635,700 + 82,300)	718,000
Share of profits of associate	(102,800)
Finance cost	45,500
Profit on disposal of property, plant and equipment (117,000 – 102,000)	(15,000)
Depreciation charge	351,600
Impairment of goodwill (W7)	40,500
Increase in inventories ((292,900 + 56,400) – 198,100)	(151,200)
Increase in trade and other receivables (177,800 – (151,800 + 26,800))	(800)
Decrease in trade and other payables ((105,800 – 3,100) – (82,500 + 12,200 – 2,200))	(10,200)
Cash generated from operations	875,600

Workings

(1) Net cash inflow on disposal of Gradgrind Ltd

	£
Net assets disposed of (388,500 x 70%)	271,950
Add: Unimpaired goodwill (56,000 – 10,000)	46,000
Profit on disposal	20,600
Less: Cash and cash equivalents at disposal	(3,500)
	335,050

(2) Interest paid

	£		£
Cash (β)	46,400	B/d	3,100
C/d	2,200	CIS	45,500
	48,600		48,600

(3) Income tax

	£		£
Cash (β)	157,400	B/d	160,000
C/d	135,000	CIS (128,000 + 4,400)	132,400
	292,400		292,400

(4) Property, plant and equipment

	£		£
B/d	1,549,000	Disposal of sub	314,000
		Other disposals	102,000
Additions (β)	965,200	Depreciation charge	351,600
		C/d	1,746,600
	2,514,200		2,514,200

(5) Investment in associate

	£		£
B/d	287,800	Cash received (β)	104,700
CIS	102,800	C/d	285,900
	390,600		390,600

(6) Share capital and premium

	£		£
		B/d (300,000 + 40,000)	340,000
		Cash received (β)	200,000
C/d (450,000 + 90,000)	540,000		
	540,000		540,000

(7) Intangibles

	£		£
B/d	289,500	Impairments (β)	40,500
		Disposal of sub (56,000 – 10,000)	46,000
		C/d	203,000
	289,500		289,500

(8) Retained earnings

	£		£
Dividends in SCE (β)	401,400	B/d	1,326,100
C/d	1,435,000	CIS	510,300
	1,836,400		1,836,400

(9) Non-controlling interest

			£
Cash (β)	1,950	B/d	301,800
Disposal (388,500 x 30%)	116,550		
C/d	279,200	CIS	95,900
	397,700		397,700

Most candidates made some attempt at this question, although performance overall was disappointing on what should have been a welcomed straightforward "processing" style question. The presentation of the statement was generally good with most candidates gaining the full presentation mark. Most candidates dealt reasonably well with those aspects of the statement of cash flows which would appear in a single entity statement; it was the consolidation issues which caused the most problems. For example, only a minority of candidates correctly added both the continuing and discontinued profit before tax figures in the reconciliation and correctly made the adjustments for the discontinued operation to the movement in inventories, trade receivable and trade payables.

A good majority of candidates correctly calculated both the purchase cost and disposal proceeds for property, plant and equipment. Dividends received from the associate was also a figure which was commonly seen as both calculated correctly and presented in the correct place within the statement. The repayment of the loan was also commonly seen as correct, although significantly less candidates managed to correctly calculate the proceeds from the share issue, with the most common error being the omission of the movement on share premium.

Most candidates made some adjustments to profit before taxation in the reconciliation. The most common errors were using the incorrect bracket convention (ie deducting instead of adding or vice versa), omitting the profit on disposal of property, plant and equipment or the impairment figure. Some candidates also made incorrect adjustments in the reconciliation by including items that were not required such as revaluations and the profit on disposal of the subsidiary.

The dividend paid to the non-controlling interest was fairly well attempted although candidates occasionally included it in the incorrect section of the statement of cash flows or forgot about the adjustment required for the discontinued operation. The disposal proceeds for the discontinued operation was often missed from the statement, although where candidates did include it a reasonable attempt was made at the calculation, the most common error being to use the whole of the subsidiary's net assets in the calculation instead of just the group share. Where a calculation was provided almost all candidates correctly deducted the cash balance on the discontinued operation.

Total possible marks Maximum full marks	17½ 17

Question 3

Overall marks for this question can be analysed as follows: **Total: 31**

General comments

Part (a) of this question required candidates to explain the financial reporting treatment of four accounting issues, given in the scenario. These covered a finance lease, borrowing costs in respect of a self-constructed asset, a foreign exchange transaction and revaluations of property, plant and equipment (both upwards and downwards). Part (b) required an explanation of any UK GAAP differences in respect of the financial reporting treatment of the four issues.

Nickleby plc

(a) IFRS accounting treatment

(1) Finance lease

Under IAS 17, Leases, the machine will be classified as a finance lease as Nickleby plc is leasing the machine for the whole of its useful life and is responsible for the maintenance and insurance of the machine during that period. The machine is also specialised in nature which increases the likelihood of it being a finance lease. Therefore, per IAS 17, the risks and rewards of ownership are deemed to have passed to the lessee. On the basis of substance over form an asset will be recognised with a corresponding liability.

The finance lease should have been capitalised at the lower of the fair value of £17,500 and the present value of the minimum lease payments and the lease liability set up. The present value of the minimum lease payments is:

	Present value calculation	£
1 July 2012	4,000	4,000
30 June 2013	4,000 / 1.15	3,478
30 June 2014	4,000 / 1.15^2	3,025
30 June 2015	4,000 / 1.15^3	2,630
30 June 2016	4,000 / 1.15^4	2,287
Present value of the minimum lease payments		15,420

The present value of the minimum lease payments is the lower figure, so the journal entry should be:

	Dr	Cr
Dr: Non-current assets – cost	£15,420	
Cr: Lease liability		£15,420

The asset should then be depreciated over the shorter of its useful life and the lease term, ie its four year useful life giving a depreciation charge of £3,855 (15,420 ÷ 4), and a resultant carrying amount of £11,565.

	Dr	Cr
Dr: Income statement: Depreciation charge	£3,855	
Cr: Non-current assets – accumulated depreciation		£3,855

The lease liability should then have been reduced by payments made and increased by interest – spreading the total finance charge of £4,580 (20,000 – 15,420) over the period of the lease using the interest rate implicit in the lease of 15%. The table below illustrates the entries which should have been made.

Year ended	*B/f*	*Interest @15%*	*Payment*	*C/f*
	£	**£**	**£**	**£**
30 June 2013 (15,420 – 4,000)	11,420	1,713	(4,000)	9,133
30 June 2014	9,133	1,370	(4,000)	6,503

The lease liability at 30 June 2013 is therefore £6,503 non-current and £2,630 current (9,133 – 6,503).

However, the £8,000 which should have been used to reduce the lease liability for 2013 has already been debited to the income statement. Only interest of £1,713 should have been charged. The correcting journal entry is:

	£	£
Dr: Lease liability (8,000 – 1,713)	6,287	
Dr: Income statement: Finance costs	1,713	
Cr: Income statement: Cost of sales		8,000

(2) Borrowing costs

IAS 23, Borrowing Costs, requires that borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset form part of the cost of that asset.

A qualifying asset is one that takes a substantial period of time to get ready for its intended use. The construction of the building is expected to take 12 months so would be a qualifying asset.

Because the funds have been borrowed specifically for the construction then the borrowing costs are directly attributable.

If surplus funds are invested the borrowing costs capitalised are to be reduced by the investment income received on the excess funds.

Capitalisation commences when the entity incurs expenditure on the asset, is incurring borrowing costs and is undertaking activities to prepare the asset for use. All of these conditions are met.

Borrowing costs can only be capitalised for the period of construction, of which six months fall into the current year. Therefore in the current year £7,100 ((£500,000 x 5% x 6/12) – 5,400) should be capitalised. To correct the entries made by the financial controller:

	£	£
Dr: Property, plant and equipment (asset in course of construction) – cost	7,100	
Dr: Income statement: Other income	5,400	
Cr: Income statement: Finance costs		12,500

As part of the cost of the asset, the borrowing costs will ultimately be depreciated over the asset's estimated useful life, once depreciation commences.

(3) Foreign exchange transaction

IAS 21, The Effects of Changes in Foreign Exchange Rates, requires a foreign currency transaction to be recorded on initial recognition in the "functional" currency" (ie that of the primary economic environment in which the entity operates – so here £) using the exchange rate at the date of the transaction.

The financial controller should therefore have recorded the transaction at the delivery date of 10 June 2013, using a rate of €1: £0.82, as that is when the risks and rewards of ownership pass.

Dr: Income statement: Purchases (€101,000 x 0.82)	£82,820	
Cr: Trade payables		£82,820

At the year end IAS 21 requires monetary items (units of currency held and assets and liabilities to be received or paid in a fixed or determinable number of units of currency) to be retranslated at the closing exchange rate. So, at the year end, the liability (ie trade payable) in respect of this transaction should be restated using the closing rate – ie to £75,750 (€101,000 x 0.75). A retranslation gain of £7,070 (82,820 – 75,750) has been made and should be recognised in profit or loss. The journal entry should be:

Dr: Trade payables	£7,070	
Cr: Income statement		£7,070

(4) Revaluations

Nickleby plc uses the revaluation model per IAS 16, Property, Plant and Equipment, so the valuation on 1 July 2012 needs to be recognised. The increase in the revaluation surplus will be disclosed in other comprehensive income. Both the land and buildings increase in value from their previous carrying amounts (W) so journal entries are:

	£	£
Dr: Property, plant and equipment – land (1,000,000 – 800,000)	200,000	
Dr: Property, plant and equipment – buildings* (2,500,000 – 1,906,000)	594,000	
Cr: Revaluation surplus		794,000

The plant falls in value from a carrying amount on 1 July 2012 of £815,700 (W) to a valuation of £450,000 – a fall in value of £365,700. £150,400 of this decrease reverses a previous revaluation so that amount is charged to the revaluation surplus and disclosed in other comprehensive income. The remaining £215,300 (365,700 – 150,400) is recognised as an expense in profit or loss. The journal entry is:

	£	£
Dr: Revaluation surplus	150,400	
Dr: Income statement: cost of sales	215,300	
Cr: Property, plant and equipment – plant and machinery		365,700

Nickleby plc also needs to recognise the depreciation charges for the year, based on the new valuations (see W). The journal entry is:

	£	£
Dr: Income statement: administrative expenses	62,500	
Dr: Income statement: cost of sales	112,500	
Cr: Property, plant and equipment – buildings		62,500
Cr: Property, plant and equipment – plant and machinery		112,500

Final carrying amounts are £1,000,000 for the land, £2,437,500 for the buildings and £337,500 for plant and machinery (W).

Nickleby plc has a policy of making an annual transfer between the revaluation surplus and retained earnings, so that needs to be made. The transfer is the difference between depreciation charges based on historic cost and those based on carrying amounts. However, this will only be in respect of the buildings as there is no longer any balance in the revaluation surplus in respect of plant and machinery. The journal entry is:

Dr: Revaluation surplus (62,500 (W) – 21,500)	£41,000	
Cr: Retained earnings		£41,000

Working

	Valuation on 1 July 2012 £	*Depreciation charge for year* £	*Carrying amount* £
Land	1,000,000	-	1,000,000
Buildings	2,500,000	(÷ 40) 62,500	2,437,500
Plant	450,000	(÷ 4) 112,500	337,500

*Tutorial note

This would be Dr to Valuation and Cr to Accumulated depreciation but the split of the carrying amount was not given so this detail could not be provided. The opposite applies to plant and machinery.

Generally this part of the question was well answered with the majority of candidates responding to all four issues and providing both explanations and calculations, although a minority of candidates failed to set out the numerical adjustments in the form of journals.
Others gave a stream of journal entries with little narrative by way of explanation, and therefore limited the number of marks they could obtain. Journals were set out in a number of different ways, with some candidates setting out several simple journals, and others combining several transactions into a single journal. All of these were given credit where appropriate, but it is important to realise that if many transactions are combined an "audit trail" must be provided. In issue (4) a number of candidates combined all of the parts of the scenario into one journal, with only a single (net) credit to the revaluation surplus and/or to property, plant and equipment, with no supporting workings, which meant that partial marks could not always be awarded. Other candidates wasted time by setting out in journal entry form the entries which had already been made.

Issue (1): Virtually all candidates identified this issue as a finance lease but very few calculated the present value of the minimum lease payments to determine the amount at which the initial asset and liability should have been recognised. Another extremely common error was a lack of consistency between the amount recognised as a liability and the amount initially recognised in the finance lease table (although most students did deduct the deposit from whatever figure they used in the leasing table). A further common inconsistency was making a statement that the amount capitalised should be the lower of the asset's fair value and the present value of the minimum lease payments and then proceeding to capitalise the higher figure.

Issue (2): The capitalisation of borrowing costs was also dealt with well with the majority of candidates recognising that interest earned needed to be deducted from the interest paid to arrive at the correct figure for capitalisation. Most candidates also identified the correct period for capitalisation as being six months only.

Issue (3): The foreign exchange transaction was not as well dealt with. A surprising number of candidates stated that the liability should be recognised when the goods were ordered rather than when received (ie when the risks and rewards of ownership transferred) although most did re-translate the liability using the year-end rate. As commented on above, a significant number of candidates failed to deal separately with the initial recognition of the liability and its retranslation at the year end, producing a combined journal entry and thereby losing marks.

Issue (4): The final issue relating to revaluations was also well dealt with, with most candidates clearly understanding the correct double entry for revaluations and the impact on subsequent depreciation. However, few candidates made the point that the valuations needed to be incorporated into the financial statements because the company had adopted the revaluation model. A pleasing number also showed the correct double entry for the reserves transfer even if the figure was not always correctly calculated. Most candidates also identified that the downwards revaluation for the plant and machinery needed to be split between the revaluation surplus and income statement.

Other common errors not referred to above included the following:

- Failing to adjust cost of sales for the full £8,000 incorrectly charged re the finance lease.
- Drawing up the finance lease table in the wrong "order" ie treating the lease as if payments were in advance rather than in arrears.
- Discounting the deposit paid.
- Failing to explain what a qualifying asset is and therefore not relating the definition to the information given in the question ie that the building was expected to take 12 months to complete.
- Dividing rather than multiplying when translating euros into sterling.
- Failing to explain where the foreign currency should be recognised ie in the income statement.
- Calculating the revaluation gain on the building incorrectly by reducing the opening carrying amount by current year depreciation.
- Making the initial debit on recognition of the liability for the foreign exchange transaction to inventories instead of to purchases.
- Calculating the reserves transfer incorrectly by dividing the revaluation surplus by remaining life (which does not work here as some of the surplus related to the land).
- Suggesting a reserves transfer for the plant and machinery even though the balance in the revaluation surplus had been eliminated by the downwards revaluation.
- Making comments which were relevant to the next financial year, rather than to this one (eg calculating a further foreign exchange loss/gain when the invoice was received after the year end).

Total possible marks	36
Maximum full marks	26

(b) UK GAAP differences

(1) Finance lease

IAS 17 lists a number of factors which would indicate that the risks and rewards of ownership have been transferred to the lessee – indicating that the lease should be classified as a finance lease.

However, under UK GAAP there is a rebuttable presumption that if, at the inception of the lease, the present value of the minimum lease payments is at least 90% of the asset's fair value then there is a finance lease.

(2) Borrowing costs

IAS 23 *requires* attributable borrowing costs to be capitalised. UK GAAP (FRS 15) gives entities the choice of whether to capitalise borrowing costs or to expense them as incurred.

Capitalisation under UK GAAP is limited to the finance costs incurred on the expenditure incurred. IAS 23 limits the amount capitalised to the borrowing costs on the total related funds *less* the investment income from any temporary investment of those funds.

(4) Revaluations

Where assets have been revalued UK GAAP (FRS 15) requires the use of existing use value rather than fair value

UK GAAP requires impairment losses to be debited first against any revaluation surplus in respect of the asset unless it reflects a consumption of economic benefits. IAS 16 does not include such a limitation. So, under UK GAAP, the whole downwards revaluation would have been debited to the profit and loss account.

Under UK GAAP a maximum period of five years between full valuations and interim valuations every three years is prescribed. No maximum period is specified by IAS 16 – the timing depends on changes in market values.

Most candidates made a reasonable attempt at identifying the differences between IFRS and UK GAAP, showing that candidates realise that these differences will always be tested and that these are relatively easy marks to gain. A number of candidates wasted time by discussing differences that were not relevant to the scenario given. A minority of candidates appeared to simply "invent" differences.

The two most common errors were believing that UK GAAP does not permit reserves transfers for revalued assets and that the "90% test" is a comparison between the length of the lease and the useful life of the asset. Candidates also need to be very careful to be precise with their wording in their answers to this type of question. For example, with regards to differences in the capitalisation of borrowing costs a number of candidates stated that under UK GAAP income on surplus funds "does not need to be netted off", which is not the same as stating that it is not netted off.

Total possible marks	6
Maximum full marks	5

Question 4

Overall marks for this question can be analysed as follows: **Total: 22**

General comments
Part (a) required the redrafting of a consolidated statement of financial position, where one subsidiary and one associate (both acquired during the year) had simply been added into the parent company's figures, and no consolidation adjustments made. Adjustments included fair value adjustments on acquisition, intra-group sales (with inventory still held at the year end), intra-group balances which did not agree and impairment write-downs. In Part (b) candidates were required to explain and justify the fair value method and the proportionate method of calculating non-controlling interest, using calculations where appropriate.

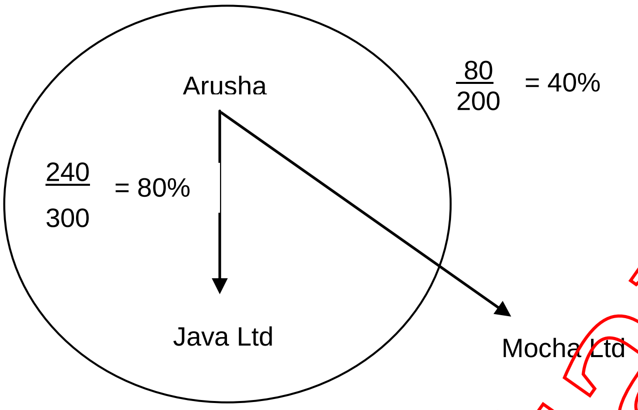
Cratchit plc

(a) Consolidated statement of financial position as at 30 June 2013

	£	£
Assets		
Non-current assets		
Property, plant and equipment (1,697,700 – 377,500)		1,320,200
Intangibles (W3)		237,600
Investment in associate (W7)		139,600
		1,697,400
Current assets		
Inventories (770,900 – 246,400 – 4,000 (W6))	520,500	
Trade and other receivables (293,000 – 99,300 – 25,600)	168,100	
Cash and cash equivalents (23,800 – 800 + 6,900)	29,900	
		718,500
Total assets		2,415,900
Equity and liabilities		
Equity attributable to owners of Cratchit plc		
Ordinary share capital (1,000,000 – 300,000 – 200,000)		500,000
Shares not yet issued (W3)		240,000
Revaluation surplus (400,000 – 150,000)		250,000
Retained earnings (W5)		917,820
		1,907,820
Non-controlling interest (W4)		120,980
Total equity		2,028,800
Current liabilities		
Trade and other payables (315,200 – 97,400 – 18,700)	199,100	
Contingent liability	20,000	
Taxation (229,000 – 61,000)	168,000	
		387,100
Total equity and liabilities		2,415,900

Workings

(1) Group structure



(2) Net assets – Drummle Ltd

	Year end	Acquisition	Post acq
	£	£	£
Share capital	300,000	300,000	
Revaluation surplus	150,000	150,000	
Retained earnings			
Per Q	224,900	108,000	
Goodwill re sole trader	(50,000)	(60,000)	
Contingent liability	(20,000)	(20,000)	
	604,900	478,000	126,900

(3) Goodwill – Drummle Ltd

	£
Consideration transferred (400,000 + (200,000 x 1.20))	640,000
Non-controlling interest at acquisition (478,000 (W2) x 20%)	95,600
Net assets at acquisition (W2)	(478,000)
	257,600
Impairments to date	(20,000)
	237,600

(4) Non-controlling interest – Drummle Ltd

	£
NCI at acquisition date (478,000 (W2) x 20%)	95,600
Share of post-acquisition reserves (126,900 (W2) x 20%)	25,380
	120,980

(5) Retained earnings

	£
Cratchit plc (1,441,200 – 224,900 – 365,600)	850,700
Drummle Ltd (126,900 (W2) x 80%)	101,520
Gargery Ltd (W7)	(10,400)
Less: PURP (W7)	(4,000)
Less: Impairments to date	(20,000)
	917,820

(6) Inventory PURP – Drummle Ltd

	%	£
SP	120	60,000
Cost	(100)	(50,000)
GP	20	10,000
x 40%		4,000

(7) Investments in associates – Gargery Ltd

	£	£
Cost		150,000
Less Share of post acquisition decrease in net assets		
Share of post acquisition losses (22,500 x 40%)	9,000	
Add: Share of additional depreciation based on FV (35,000 ÷ 5 x 6/12 x 40%)	1,400	
		(10,400)
		139,600

This part of the question was reasonably well answered with most candidates producing an adequately presented consolidated statement of financial position (although a lack of sub-totals and the use of abbreviations were common). The vast majority of candidates did correctly identify the group structure and realised that the assets and liabilities incorrectly included for the associate needed to be "backed out" and the share capital corrected to be that of the parent company only. Where a draft consolidated statement is provided in the question it is extremely important that candidates read the information provided carefully to ascertain exactly on what basis the "consolidation" has been done.

Most candidates calculated the consideration for the subsidiary acquired during the year correctly (using the correct share price) although hardly any then included the shares not yet issued in equity in their consolidated statement of financial position (hence failing to complete the double entry). Even those who did realise that this needed to be recognised in the statement of financial position often included it in liabilities. The other most common error was failing to show the contingent liability recognised as a fair value adjustment in liabilities.

Other common errors included the following :

- Failing to adjust for the cash in transit correctly by deducting the same figure from payables and receivables and/or deducting the amount (rather than adding it) to cash.
- Not adjusting the net assets working for the goodwill held by the subsidiary (or only adjusting for the £10,000 change in value).
- Not adjusting the net assets working for the contingent liability (or adding rather than deducting it).
- Failing to multiply the PURP by the % of shares held in the associate.
- Deducting the above PURP from the investment in the associate rather than from inventories.
- Including the fair value excess in the investment in associate working.
- Failing to multiply the increase in depreciation by the % held in the associate in the above working.
- Not recognising that the same figures re post acquisition adjustments in the investment in associate should also be shown in consolidated retained earnings.
- Calculating the non-controlling interest as a % of post-acquisition profits rather than as a % of closing net assets.
- Deducting a share of the goodwill impairment in the NCI working even though the proportionate method was being used.

As always some candidates lost marks by failing to show an "audit trail" for the basic consolidation on the face of the statement of financial position and/or for the calculation of the non-controlling interest and % of post- acquisition profits.

Total possible marks	17½
Maximum full marks	17

(b) The two methods of calculating goodwill and non-controlling interest

IFRS 3 allows two methods of measuring the non-controlling interest (NCI) at the acquisition date:
(i) At its fair value (the "fair value method")
(ii) At the NCI's share of the acquiree's net assets (the treatment used in (a), ie the "proportionate method").

Method (ii) results in goodwill being, in effect, the difference between the cost of the parent's investment and its share of the net assets acquired. The rationale behind this is that this market transaction has only provided evidence of the amount of the *parent entity's* goodwill – there has been no evidence of the amount of the goodwill attributable to the NCI.

However, this method means that only the parent's share (here 80%) of the goodwill of the subsidiary will be recognised – when for every other line item on a consolidated statement of financial position the parent brings in 100% of the subsidiary's figures, to reflect the fact that the parent has *control* over that subsidiary.

Method (i), the fair value method, is consistent with the rest of IFRS 3 since IFRS 3 requires both the consideration transferred and the net assets acquired to be measured at fair value. It works on the basis that the goodwill attributable to the NCI can be calculated from the estimate of the fair value of the NCI itself.

The fair method usually results in a higher amount for the NCI/goodwill – the difference between this amount and the amount as traditionally measured is effectively added to the goodwill acquired in the business combination and is the goodwill attributable to the NCI at the acquisition date.

If NCI had been measured in Part (a) using the fair value method it would have been calculated as follows, resulting in an NCI higher than that under the proportionate method:

	£
FV of NCI at acquisition	100,000
Share of post-acquisition reserves (126,900 (W2) x 20%)	25,380
	125,380
Less: Impairment to date (20,000 x 20%)	(4,000)
	121,380

As shown above, where NCI has been measured at fair value and there is a subsequent impairment to goodwill, part of that impairment will be charged to the NCI at the end of the reporting period, based on the NCI%.

If goodwill had been measured in Part (a) using the fair value method it would have been calculated as follows:

	£
Consideration transferred (a)	640,000
FV of NCI at acquisition	100,000
Net assets at acquisition (a)	(478,000)
	262,000
Less: Impairment to date	(20,000)
	242,000

This part of the question was poorly answered with a significant minority of candidates making no attempt to produce an answer. Those candidates who did attempt this part of the question focused on calculations, with very few showing any understanding of the conceptual issues relating to the two methods. Those who did attempt some narrative tended to describe the underlying mechanics of the calculations as opposed to the principles underlying them. Many candidates wasted time by copying out entire workings for goodwill and the non-controlling interest produced in Part (a) of their answer (for which there were no further marks available) rather than just referring back to the relevant figures and calculating the alternatives using the fair value method. A significant number of candidates clearly did not understand the full double entry for an impairment when using the fair value method and it was common to see just the parent company's share of the impairment deducted from the carrying value of the goodwill.

Total possible marks	8
Maximum full marks	5

PROFESSIONAL LEVEL EXAMINATION

MONDAY 8 DECEMBER 2014

(3 hours)

FINANCIAL ACCOUNTING AND REPORTING

This paper consists of **FOUR** questions (100 marks).

1. Ensure your candidate details are on the front of your answer booklet.
2. Answer each question in black ballpoint pen only.
3. Answers to each question must begin on a new page and must be clearly numbered. Use both sides of the paper in your answer booklet.
4. The examiner will take account of the way in which answers are presented.
5. When the assessment is declared closed, you must stop writing immediately. If you continue to write (even completing your candidate details on a continuation booklet), it will be classed as misconduct.

Unless otherwise stated, make all calculations to the nearest month and the nearest £.

All references to IFRS are to International Financial Reporting Standards and International Accounting Standards.

IMPORTANT Question papers contain confidential information and must NOT be removed from the examination hall. **DO NOT TURN OVER UNTIL YOU ARE INSTRUCTED TO BEGIN WORK**	You MUST enter your candidate number in this box.

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1. Trakehner Ltd operates a chain of garden centres in the UK. Jamie, the financial controller of Trakehner Ltd, has prepared draft financial statements for the year ended 30 June 2014. These draft financial statements are set out below, along with some outstanding issues.

Draft statement of profit or loss for the year ended 30 June 2014

	£
Revenue	3,879,600
Cost of sales	(2,015,300)
Gross profit	1,864,300
Administrative expenses (Note 3)	(987,600)
Distribution costs	(398,400)
Profit from operations	478,300
Investment income (Note 1)	3,000
Profit before tax	481,300
Income tax (Note 5)	(120,000)
Profit for the year	361,300

Draft statement of financial position as at 30 June 2014

	£	£
ASSETS		
Non-current assets		
Property, plant and equipment (Notes 1 and 2)		1,982,500
Current assets		
Inventories	453,700	
Trade and other receivables	241,200	
Cash and cash equivalents	14,800	
		709,700
Total assets		**2,692,200**
EQUITY AND LIABILITIES		
Equity		
Ordinary share capital (£1 shares) (Note 3)		800,000
5% Preference share capital (Note 4)		200,000
Share premium		125,000
Retained earnings		871,600
		1,996,600
Non-current liabilities		
Loan (Note 1)		250,000
Current liabilities		
Trade and other payables	302,600	
Income tax (Note 5)	143,000	
		445,600
Total equity and liabilities		**2,692,200**

The following matters are outstanding:

(1) On 1 October 2013 construction commenced on a new garden centre. On that date Trakehner Ltd took out a loan of £250,000 specifically to finance this project. Construction costs to date of £176,000 have been included in property, plant and equipment. The interest rate on the loan is 4% pa, payable on 1 July annually, and the loan is repayable on 30 September 2015. The only accounting entries made in respect of the loan were to recognise its receipt. Interest received on the temporary investment of surplus funds was £3,000, which Jamie recognised as investment income. Construction of the garden centre was still in progress at 30 June 2014.

(2) Depreciation on property, plant and equipment has not yet been charged as Jamie was unsure how to treat the construction costs above. The carrying amount of £1,982,500 in the draft statement of financial position can be analysed as follows:

	£
New garden centre construction costs (Note 1)	176,000
Land	600,000
Other buildings (cost £950,000)	779,600
Plant and equipment	426,900
	1,982,500

Buildings are depreciated on a straight-line basis over 50 years, with the charge being included in administrative expenses. Plant and equipment is depreciated on a reducing balance basis using a rate of 25%, with the charge being included in cost of sales.

(3) On 1 January 2014 Trakehner Ltd made a 1 for 4 bonus issue of ordinary shares. No accounting entries have been made for these shares, although the correct number of shares was issued. The intention was to use the share premium account as far as possible.

An interim ordinary dividend of 10p per share, based on the correct number of shares in issue, was paid on 15 February 2014 and posted to administrative expenses.

(4) On 1 July 2013 Trakehner Ltd issued 200,000 5% redeemable preference shares at their par value of £1 per share. These shares are redeemable on 30 September 2018 at a premium. The preference dividend is paid annually in arrears on 1 July and no accrual has been made for this dividend. The effective interest rate of the preference shares is 5.6% pa.

(5) Income tax of £120,000 in the draft statement of profit or loss is the amount that Jamie has appropriately estimated will be payable for the current year. The figure of £143,000 in the draft statement of financial position includes the over provision of income tax of £23,000 from the year ended 30 June 2013.

(6) Adjustment needs to be made at 30 June 2014 for prepaid distribution costs of £10,500 and accrued administrative expenses of £12,600.

Requirements

(a) Prepare a revised statement of profit or loss for Trakehner Ltd for the year ended 30 June 2014 and a revised statement of financial position as at that date, in a form suitable for publication. Notes to the financial statements are **not** required. **(22 marks)**

(b) Explain the nature and required IFRS financial reporting treatment of redeemable preference shares. **(3 marks)**

(c) Describe the differences between IFRS and UK GAAP in respect of the treatment of borrowing costs. **(2 marks)**

Total: 27 marks

2. Ryan, an ICAEW Chartered Accountant, is the finance director of Holstein Ltd and also owns 20% of the company's ordinary shares. Ryan has just finished preparing the draft financial statements for the year ended 30 June 2014, which show a profit before tax of £135,400, total assets of £1,456,000 and total liabilities of £874,300. You are the financial controller of Holstein Ltd, and a recently qualified ICAEW Chartered Accountant.

You are aware that the financial statements will come under close scrutiny by Holstein Ltd's bank, as it will be looking to ensure that the conditions of a loan covenant are still met. This covenant requires Holstein Ltd to maintain total assets at a minimum of 150% of total liabilities. If this condition is not met the bank is likely to call in its loan and the company's future would be in jeopardy.

Whilst assisting Ryan with the drafting of the financial statements you discovered the following matters of concern:

(1) Holstein Ltd's stated accounting policy has been to depreciate all general machines on a straight-line basis over four years. However, during the current year, the board of directors decided that, with effect from 1 July 2013, all general machines should be depreciated using a reducing balance basis at a rate of 25%, as this better reflects their economic usage.

Ryan has restated the opening balance of general machines and retained earnings as if the new policy had always been in existence, on the grounds that this is a change of accounting policy in accordance with IAS 8, Accounting Policies, Changes in Accounting Estimates and Errors. As a result, Ryan increased the carrying amount of property, plant and equipment and retained earnings at 1 July 2013 by £352,100. Ryan then charged depreciation at 25% on the revised carrying amount of property, plant and equipment.

(2) On 1 December 2013 Holstein Ltd received a government grant of £200,000, representing 50% of the cost of a specialised asset that was acquired on 1 October 2013. The asset has a four-year life with no residual value and has been correctly depreciated in the draft financial statements on a straight-line basis. Holstein Ltd's stated accounting policy is to account for government grants using the netting-off method. Ryan has shown the full grant of £200,000 within other income in the draft financial statements as he does not expect the grant to be repaid and the asset has already been paid for.

(3) On 1 July 2013 Holstein Ltd signed a four-year lease for a machine with a fair value of £350,000. The lessor remains responsible for maintenance and insurance of the machine. Ryan negotiated a payment "holiday" so an annual payment of £60,000 is due on 1 July 2014, 2015 and 2016. Because no payment was made in the year ended 30 June 2014 Ryan has not included any amounts in respect of this lease in the draft financial statements.

(4) A machine which became surplus to requirements in May 2014 was sold for £170,000 on 15 August 2014, incurring selling expenses of £11,600. On 1 August 2014 Holstein Ltd incurred reconditioning expenses of £63,500. These expenses were required to bring the machine into a saleable and usable condition but Holstein Ltd had had to wait for a suitable specialist to be available to carry out this work.

The board of directors had agreed to sell the machine on 1 June 2014 and had duly advertised it at a price of £300,000. In view of this on 30 June 2014 Ryan revalued the machine from its carrying amount of £155,000 on 30 June 2014 to its advertised selling price, posting the difference to the revaluation surplus, disregarding Holstein Ltd's published accounting policy which is to use the cost model.

When you queried this with Ryan he quoted the requirement of IFRS 5, Non-current Assets Held for Sale and Discontinued Operations to revalue an asset to its fair value immediately before classification as held for sale. The asset is shown in the draft statement of financial position as at 30 June 2014 as an asset held for sale at £300,000. Ryan intends to account for the actual disposal in the financial statements for the year ended 30 June 2015.

You have discussed these matters with Ryan, who does not accept that any adjustments are needed to the financial statements.

Requirements

(a) Explain the required IFRS financial reporting treatment of the four issues above in the financial statements for the year ended 30 June 2014, preparing all relevant calculations. **(21 marks)**

(b) Using your results from Part (a) calculate revised figures for profit before tax, total assets and total liabilities. **(4 marks)**

(c) Discuss the ethical issues arising from the scenario for you, as financial controller of Holstein Ltd, and list the steps that you should take to address them. **(5 marks)**

Total: 30 marks

3. On 1 July 2013 Appaloosa plc had a number of subsidiary companies, all acquired several years ago. Extracts from the group's consolidated financial statements for the year ended 30 June 2014 are set out below.

Consolidated statement of profit or loss for the year ended 30 June 2014 (extract)

Continuing operations	**£**
Profit from operations	1,589,600
Finance costs	(51,300)
Profit before tax	1,538,300
Income tax expense	(385,000)
Profit for the year from continuing operations	1,153,300
Discontinued operations	
Profit for the year from discontinued operations	77,500
Profit for the year	1,230,800
Attributable to:	
Owners of Appaloosa plc	1,015,300
Non-controlling interest	215,500
	1,230,800

Consolidated statement of financial position as at 30 June

	2014	**2013**
ASSETS	**£**	**£**
Non-current assets	3,214,500	2,478,000
Current assets		
Inventories	1,785,900	1,025,100
Trade and other receivables	725,200	699,800
Cash and cash equivalents	101,500	53,500
	2,612,600	1,778,400
Total assets	**5,827,100**	**4,256,400**
EQUITY AND LIABILITIES		
Equity		
Ordinary share capital (£1 shares)	500,000	400,000
Share premium account	100,000	40,000
Revaluation surplus	779,500	423,000
Retained earnings	2,279,800	1,364,800
Attributable to the equity holders of Appaloosa plc	3,659,300	2,227,800
Non-controlling interest	664,900	742,600
	4,324,200	2,970,400
Non-current liabilities		
Finance lease liabilities	350,200	270,000
Current liabilities		
Trade and other payables	582,500	489,800
Finance lease liabilities	150,200	148,200
Income tax payable	420,000	378,000
	1,152,700	1,016,000
Total equity and liabilities	**5,827,100**	**4,256,400**

Additional information:

(1) On 1 January 2014 Appaloosa plc sold all of its 70% holding in Connemara Ltd's 100,000 £1 ordinary shares, for cash of £590,000. Appaloosa plc had paid £350,000 for the shares in Connemara Ltd when the retained earnings of Connemara Ltd were £226,000. Goodwill was calculated using the proportionate method, although £50,000 of this amount had been written off by 30 June 2013. The profit from discontinued operations in the consolidated statement of profit or loss above relates wholly to the sale of the shares in Connemara Ltd and includes an income tax expense of £19,600.

The net assets of Connemara Ltd at the date of disposal were as follows:

	£
Property, plant and equipment	705,200
Trade and other receivables	57,900
Cash and cash equivalents	13,800
Trade and other payables	(42,700)
	734,200

(2) All finance costs in the consolidated statement of profit or loss relate to finance leases. In the year ended 30 June 2014 Appaloosa plc entered into finance leases for assets with a cash price of £550,000.

(3) Non-current assets comprise property, plant and equipment and goodwill which had arisen on business combinations. The only movement on goodwill during the year ended 30 June 2014 was with regard to Connemara Ltd. Depreciation of £561,500 was recognised during the year ended 30 June 2014. No property, plant and equipment was disposed of during the year other than through the disposal of Connemara Ltd.

(4) The consolidated statement of changes in equity shows the following:

- ordinary dividends were paid during the year to both the shareholders of Appaloosa plc and to the non-controlling interest;
- there was a revaluation of property, plant and equipment;
- Appaloosa plc made an issue of ordinary shares.

Requirements

(a) Calculate the profit on disposal of Connemara Ltd. **(2 marks)**

(b) Prepare a consolidated statement of cash flows for Appaloosa plc for the year ended 30 June 2014, including a note reconciling profit before tax to cash generated from operations, using the indirect method. A note showing the effects of the disposal of Connemara Ltd is **not** required. **(14 marks)**

(c) The IASB's Conceptual Framework identifies a wide range of users who use financial statements to make economic decisions. Identify **five** possible user groups and, for each user group, list the type(s) of decisions they regularly make from information contained within the financial statements. **(5 marks)**

Total: 21 marks

PLEASE TURN OVER

4. On 1 July 2013 Oldenburg plc had one subsidiary company, Zangersheide Ltd, and one associated company, Hanoverian Ltd, holding 90% and 30% respectively of their ordinary shares.

On 1 October 2013 Oldenburg plc acquired 80% of the ordinary shares of Westphalian Ltd. Initial calculations showed that a gain on bargain purchase ("negative goodwill") of £35,000 arose on the acquisition. In accordance with best practice, a reassessment of Westphalian Ltd's assets, liabilities and contingent liabilities and consideration transferred took place following acquisition and the following discoveries were made:

- The consideration transferred used in the goodwill calculation was £500,000, which included professional fees of £8,000 relating to the acquisition.
- A building which had been purchased by Westphalian Ltd for £300,000 on 1 October 1999 was assessed as having a fair value on the date of Westphalian Ltd's acquisition by Oldenburg plc of £154,000. This fair value had not been reflected in the goodwill calculation. The building has always had a total estimated useful life of 25 years. Depreciation on buildings is presented in operating expenses.
- Westphalian Ltd's financial statements for the year ended 30 June 2013 included a disclosure note showing a contingent liability of £42,000. This contingent liability had a fair value of £36,500 on 1 October 2013. This fair value was unchanged at 30 June 2014. No allowance was made for this contingent liability in the goodwill calculation.
- Oldenburg plc had decided to use the fair value method to measure goodwill and the non-controlling interest for Westphalian Ltd. However, the original calculation had incorrectly used the proportionate method. The fair value of the non-controlling interest at 1 October 2013 was £140,000.

Extracts from the individual statements of profit or loss of the four companies for the year ended 30 June 2014 are set out below:

Statements of profit or loss for the year ended 30 June 2014

	Oldenburg plc £	Zangersheide Ltd £	Westphalian Ltd £	Hanoverian Ltd £
Revenue	2,978,500	1,759,500	1,310,400	713,000
Cost of sales	(2,100,600)	(1,198,500)	(874,600)	(471,400)
Gross profit	877,900	561,000	435,800	241,600
Operating expenses	(701,600)	(203,500)	(300,000)	(156,300)
Profit before taxation	176,300	357,500	135,800	85,300
Income tax expense	(53,000)	(107,200)	(40,000)	(24,200)
Profit for the year	123,300	250,300	95,800	61,100

Additional information:

(1) During the current year Oldenburg plc purchased goods to the value of £286,800 and £101,040 from Zangersheide Ltd and Hanoverian Ltd respectively. All sales between group companies are at a 20% mark up. Half of the goods purchased were still in Oldenburg plc's inventories at 30 June 2014.

(2) During the previous year, on 31 December 2012, Zangersheide Ltd sold a machine to Oldenburg plc for £567,000. At that date, the machine had a carrying amount in Zangersheide Ltd's books of £465,500 and the estimated remaining useful life was reassessed at five years. Depreciation on this machine is presented in cost of sales.

(3) At 30 June 2014 impairment losses of £18,000 in respect of goodwill arising on the business combination with Zangersheide Ltd and £6,000 in respect of the carrying amount of Hanoverian Ltd need to be recognised in the consolidated financial statements. Oldenburg plc used the proportionate method to measure goodwill and the non-controlling interest for Zangersheide Ltd.

Requirements

(a) Calculate a revised figure for the gain on bargain purchase arising on the business combination with Westphalian Ltd. **(5 marks)**

(b) Prepare the consolidated statement of profit or loss for Oldenburg plc for the year ended 30 June 2014. **(14 marks)**

(c) Describe any differences between IFRS and UK GAAP in respect of the financial reporting treatment of the issues in Parts (a) and (b) above. **(3 marks)**

Total: 22 marks

MARK PLAN AND EXAMINER'S COMMENTARY

The marking plan set out below was that used to mark this question. Markers were encouraged to use discretion and to award partial marks where a point was either not explained fully or made by implication. More marks were available than could be awarded for each requirement. This allowed credit to be given for a variety of valid points which were made by candidates.

Question 1

Total Marks: 27

General comments

Part (a) of this question tested the preparation of a statement of profit or loss and a statement of financial position from a set of draft financial statements plus a number of adjustments. Adjustments included borrowing costs and depreciation on property, plant and equipment, a bonus issue of ordinary shares, the issue of redeemable preference shares and dividends on both types of shares. Part (b) required an explanation of the treatment of redeemable preference shares. Part (c) tested the differences between IFRS and UK GAAP in respect of the treatment of borrowing costs.

Trakehner Ltd

(a) Financial statements

Statement of profit or loss for the year ended 30 June 2014

	£
Revenue	3,879,600
Cost of sales (W1)	(2,122,025)
Gross profit	1,757,575
Administrative expenses (W1)	(919,200)
Distribution costs (W1)	(387,900)
Profit from operations	450,475
Finance cost (W4)	(11,200)
Profit before tax	439,275
Income tax expense (120,000 – (143,000 – 120,000))	(97,000)
Profit for the year	342,275

Statement of financial position as at 30 June 2014

	£	£
Assets		
Non-current assets		
Property, plant and equipment (W2)		1,861,275
Current assets		
Inventories	453,700	
Trade and other receivables (241,200 + 10,500)	251,700	
Cash and cash equivalents	14,800	
		720,200
Total assets		2,581,475
Equity and liabilities		
Equity (W3)		
Ordinary share capital		1,000,000
Retained earnings		677,575
		1,677,575
Non-current liabilities		
Preference share capital (5% redeemable) (211,200 (W4) – 10,000)	201,200	
Borrowings	250,000	
		451,200

Current liabilities			
Trade and other payables (302,600 + 12,600)		315,200	
Loan interest (W2)		7,500	
Preference dividend (200,000 x 5%)		10,000	
Taxation		120,000	
			452,700
Total equity and liabilities			2,581,475

Workings

(1) Costs matrix

	Cost of sales	*Admin expenses*	*Distribution costs*
	£	**£**	**£**
Per draft	2,015,300	987,600	398,400
Depreciation (W2)	106,725	19,000	
Ordinary dividend (1,000,000 (W3) x 10p)		(100,000)	
Accrual and prepayment		12,600	(10,500)
	2,122,025	919,200	387,900

(2) PPE

	£
Carrying amount per draft	1,982,500
Loan interest ((250,000 x 4% x 9/12) – 3,000)	4,500
Depreciation on other property (950,000/50)	(19,000)
Depreciation on plant and equipment (426,900 x 25%)	(106,725)
	1,861,275

(3) Equity

	Ordinary share capital	*Share premium*	*Retained earnings*
	£	**£**	**£**
Per draft	800,000	125,000	871,600
Bonus issue (800,000 ÷ 4)	200,000	(125,000)	(75,000)
Ordinary dividend (W1)	–	–	(100,000)
Decrease in profit for the year (361,300 – 342,275)	–	–	(19,025)
	1,000,000	–	677,575

(4) Redeemable preference shares

	Opening balance	*Interest expense (5.6%)*	*Interest paid (5%)*	*Closing balance*
Year	**£**	**£**	**£**	**£**
30 June 2014	200,000	11,200	Nil	211,200

Generally candidates made a good attempt at this part of the question and nearly all produced complete statements of financial position and profit or loss with many gaining the full marks available for presentation. The bonus issue, calculation of current year depreciation charges and adjustments for prepayments and accruals were almost always dealt with correctly. Most candidates also recognised that the redeemable preference shares should be treated as a liability rather than equity.

The capitalisation of interest appeared to cause the most problems. Although most candidates recognised that interest on a qualifying asset should be capitalised many struggled with the calculation. The most common mistakes were basing the amount on the costs incurred rather than the amount borrowed, using the wrong number of months in the calculation, and not netting off the interest received. A number of candidates also depreciated the new asset even though it had not yet been completed. It was also worrying to see a lack of understanding regarding the double entry treatment of interest with a significant number of candidates both capitalising and expensing the figure calculated. As always with property, plant and equipment it was often difficult to find an "audit trail" supporting the final figure taken to the statement of financial position.

In contrast, most candidates did use the recommended "costs matrix" when allocating costs for the statement of profit or loss, and entered the adjustments into the correct columns. Occasionally errors were made in terms of whether the adjustment was increasing or decreasing costs particularly with regard to the dividend incorrectly posted to administrative expenses and a minority of candidates posted the accrual and/or prepayment in the wrong (sometimes the same) direction(s).

Other common errors included the following:

- Adding, rather than deducting, the prior year over provision of income tax to the current year charge (or making no adjustment for it at all).
- Using the same income tax figure in both the statement of profit or loss and the statement of financial position (thereby omitting to complete the correct double entry).
- Treating the redeemable preference shares as a compound financial instrument (and wasting significant time by discounting future cash flows to calculate the "liability" element).
- Failing to realise that the interest on the redeemable preference shares was unpaid at the year end.
- Splitting the loan into current and non-current components.
- Adding the revised profit for the year to retained earnings but failing to deduct the original profit already included.

Total possible marks	23½
Maximum full marks	22

(b) Financial reporting treatment of redeemable preference shares

Preference shares give the holder the right to receive an annual dividend (ie mandatory) (usually at a fixed rate), which may be also be cumulative, out of the profits of a company, together with a fixed amount on the ultimate liquidation of the company or at an earlier date if the shares are redeemable.

Legally, preference shares are equity. However, IAS 32 treats most preference shares as liabilities. This is because they are, in substance, loans and meet the definition of a liability as there is a present obligation, in the form of both preference dividends and redemption payments, which will lead to a future outflow.

The liability is measured at amortised cost using the effective interest rate, so that the premium on redemption is effectively treated as part of the interest expense.

The interest is treated as a finance cost in the statement of profit or loss, rather than as a distribution out of retained earnings.

Again, this was well answered with most candidates discussing substance over form and explaining why redeemable preference shares should be treated as a liability. Almost all candidates also followed this through by explaining that the resulting "dividend" should be treated as a finance cost. Fewer candidates discussed the use of amortised cost and effective interest rate.

Total possible marks	6½
Maximum full marks	3

(c) UK GAAP differences re borrowing costs

Under UK GAAP (FRS 15) there is a choice as to whether to capitalise borrowing costs or to recognise them as an expense when incurred. Under IFRS (IAS 23) capitalisation is mandatory.

Under UK GAAP the amount capitalised is limited to the finance costs on the expenditure incurred. Under IFRS the amount capitalised is limited to the borrowing costs on the total related funds less the investment income from any temporary investment of those funds.

This part was also well answered with a significant number of candidates achieving full marks and nearly all candidates as a minimum flagging up the difference in respect of optional versus mandatory capitalisation of interest costs. However, a few candidates lost marks by being imprecise in their wording – for example saying that under IFRS companies "can" as opposed to "should" capitalise interest, thereby losing half a mark. Other answers failed to make it clear that it is surplus investment income on these particular borrowings which should be offset under IFRS, as opposed to any investment income.

Total possible marks	2
Maximum full marks	2

Question 2

Total Marks: 30

General comments

Part (a) of this question required candidates to explain the financial reporting treatment of four accounting issues, given in the scenario. The issues covered a change in depreciation method of equipment, a government grant, a lease and a potential held for sale asset. Part (b) required the calculation of revised figures for profit before tax, total assets and total liabilities. Part (c) required an explanation of the ethical issues arising from the scenario and the action to be taken.

Holstein Ltd

(a) IFRS accounting treatment

(1) Change of depreciation method

IAS 16, Property, Plant and Equipment, requires companies to reassess the accounting estimates used to calculate depreciation each year. If the reducing balance method is a better reflection of the pattern of consumption of economic benefits then it is correct to change to this method.

Ryan is correct that a change of accounting policy is dealt with by making a retrospective adjustment to opening figures. However, per IAS 16, a change to the depreciation method is a change in an accounting estimate, not a change of accounting policy.

Changes in accounting estimates are dealt with, per IAS 8 prospectively, not retrospectively, by depreciating the carrying amount of the asset at the date of the change under the new method. Therefore the adjustment of £352,100 must be reversed out, reducing the opening balances of both property, plant and equipment and retained earnings.

Ryan must have charged depreciation of 25% on this wrongly inflated carrying amount. Hence, depreciation for the year ended 30 June 2014 is overstated by £88,025 (352,100 x 25%). Property, plant and equipment is therefore understated by the same amount. Overall there is a net overstatement of property, plant and equipment of £264,075 ((352,100 – 88,025) or (352,100 x 75%)).

(2) Government grant

Per IAS 20, Accounting for Government Grants and Disclosure of Government Assistance, grants should be recognised when there is reasonable assurance that:

- the entity will comply with the relevant conditions, and
- the entity will receive the grant.

Ryan does not expect to have to repay the grant and the grant has been received. Both of these conditions therefore appear to have been met so it is appropriate to recognise the grant.

IAS 20 requires grants to be recognised in profit or loss over the periods in which the entity recognises the expenses which the grants are intended to compensate. It is against the accruals principle to recognise a grant on a cash receipts basis, which is what has been done here.

Holsten Ltd's stated accounting policy for government grants is to use the netting-off method. Under this method the grant is deducted from the carrying amount of the related asset. The grant will then be recognised over the life of the related asset by way of a reduced depreciation charge.

The cost of the asset will therefore be stated at £200,000 (or for saying Cr £200,000 to PPE) (400,000 – 200,000), with accumulated depreciation of £37,500 (200,000 x 9/48). The carrying amount of the asset at 30 June 2104 is therefore £162,500 (200,000 – 37,500).

Because Ryan has already charged depreciation of £75,000 (400,000 x 9/48) and credited the statement of profit or loss with income of £200,000 ie a net credit of £125,000, profit before tax needs to be reduced (Dr) by £162,500 (125,000 + 37,500). The corresponding Cr will reduce total assets in the statement of financial position.

(3) Operating lease

Per IAS 17, Leases, this is an operating lease because the risk and rewards of ownership have not passed to the lessee (eg maintenance/insurance, use of the asset over the majority of its useful life, present value of minimum lease payments below fair value of £350,000)

The lease payments of £180,000 (3 x £60,000) should be charged on a straight-line basis over the four year lease term, even if the payments are not made on such a basis. This is in accordance with the accruals principle. Hence, £45,000 (£180,000 x 25%) should be charged to the statement of profit or loss in the year ended 30 June 2014. An accrual of £45,000 will be included within current liabilities.

(4) Asset held for sale

IFRS 5, Non-current Assets Held for Sale and Discontinued Operations, states that an asset should be classified as held for sale when there is intention to recover the carrying amount through resale. However, there are strict criteria which must be satisfied before the IFRS rules can be applied.

Although the decision by the board shows intent, the asset was *not* immediately available for resale as the reconditioning work could not be carried out until August.

Also the fact that the machine was advertised at a price significantly above the final sale price means that the sale was not "highly probable".

Therefore the held for sale criteria were not met at the year end and the asset should be removed from this classification. The increase in value of (300,000 – 155,000) £145,000 should be removed from total assets and the revaluation surplus, taking the carrying amount back to £155,000, which correctly includes depreciation to 30 June 2014 (or continue to depreciate).

However, as the plant is "surplus to requirements" this is an indication that an impairment review is required under IAS 36, Impairment of Assets. The carrying amount of £155,000 is then compared with the recoverable amount, being the higher of fair value less costs to sell and value in use. As the asset has now been sold/is surplus to requirements its value in use, ignoring discounting, will equal fair value less costs to sell so this figure should be used. This is £94,900 (170,000 – 11,600 – 63,500). Therefore an impairment of £60,100 (155,000 – 94,900) should be recognised in the statement of profit or loss.

Even if the held for sale criteria had been met, as Holstein Ltd uses the cost model and not the revaluation model, the asset would not be revalued to fair value immediately before the classification – it would be left at its carrying amount, or written down to fair value less costs to sell, if lower.

Answers to Part (a) of this question were very disappointing, although the majority of candidates did attempt all four issues and provide both explanations and supporting calculations. The majority of candidates did not achieve a pass mark on this question.

Issue (1): This was probably the worst answered part of the question with many candidates believing that the change in the basis of calculating depreciation constituted a change in accounting policy. As a result they thought the current accounting treatment correct then wasted time writing out at length when accounting policies can be changed and what the disclosure requirements are. Other candidates seemed to think that the company was moving to a revaluation basis. Even those candidates who did recognise this was a change in an accounting estimate could rarely say more than that it should be applied prospectively.
However, even those candidates who incorrectly believed this was a change in policy often managed to pick some marks up by stating that the adjustment to opening balances should be reversed out and often managed to calculate the correct adjustment to depreciation.

Issue (2): This was better dealt with and many candidates correctly calculated the adjustments required with regard to the government grant (although it was common to see depreciation calculated for an incorrect number of months). However, a significant number of candidates wasted time by discussing at length the two different methods allowed for the treatment of capital grants even though the question clearly stated that the netting off method was to be used. Some then went on to produce the figures under both methods. Almost all candidates recognised that the grant should be reversed out of other income (although some seemed to think that if the deferred income approach had been used it would have been acceptable to recognise the grant in full immediately).

Issue (3): This was the best answered part of this question. Virtually all candidates referred to the relevant information in the question that indicated this was an operating lease. Most also understood that the total cost needed to be spread over the life of the lease although some referred to this but then went on to state that the current year cost should simply be the payment to be made next year. Whilst almost all candidates specifically stated that this was a cost to be recognised in the statement of profit or loss fewer discussed the credit side of the entry and the need for an accrual.

A significant minority of candidates again showed a worrying lack of understanding of double entry by recognising the correct expense but then showing as a liability the total outstanding payments. Others also incorrectly described the expense as a finance cost. Only a very small minority believed the lease to be a finance lease.

Issue (4): This was also badly answered. Many candidates wasted time by listing out all the criteria to determine if an asset should be treated as held for sale, rather than using the information in the question to demonstrate which of the criteria had not been met. Many candidates did not see the relevance of the reconditioning expenses incurred after the year end to the decision as to whether the asset should be classified as held for sale and as a result concluded that the asset had correctly been classified as held for sale. As a result they did not gain the total marks available for discussing the need for an impairment review on the grounds that the asset had become surplus to requirements, as opposed to on the grounds of it being a held for sale asset. However, even these candidates usually recognised that the revaluation was inappropriate and that the entry in the revaluation surplus needed to be reversed out (although fewer justified why this was).

Total possible marks Maximum full marks	31 21

(b) Revised figures

	Profit/(loss) before tax	**Total assets**	**Total liabilities**
	£	**£**	**£**
Per draft	135,400	1,456,000	874,300
(1) Change of depreciation method			
– reverse prior period adjustment		(352,100)	
– adj to annual deprec charge	88,025	88,025	
(2) Government grant	(162,500)	(162,500)	
(3) Operating lease	(45,000)		45,000
(4) Asset held for sale – reverse revaluation		(145,000)	
– impairment	(60,100)	(60,100)	
	(44,175)	824,325	919,300

Again, answers to this part were not as good as usual and there was less evidence of candidates setting up the adjustment working up front and entering the figures as they worked through Part (a) of the question. It was often difficult to follow figures from Part (a) to Part (b) and/or adjustments referred to in Part (a) were simply not transferred to the adjustments table. It was also clear that many candidates struggled to understand which adjustments would impact on, for example, both profit and total assets or just profit.

Total possible marks Maximum full marks	5 4

(c) Ethical issues

Ryan has given reasons for the accounting treatment he has adopted for some of the issues identified. However, although some of these explanations may appear reasonable to a non-accountant, they are incorrect and Ryan, as an ACA, should be aware of this.

It therefore seems that either Ryan has not been keeping himself technically up-to-date (which is a requirement of his membership of ICAEW) *or* he has deliberately misstated these items, possibly so that Holstein Ltd still appears to meet the conditions of its loan, and/or as Ryan holds a significant percentage of shares in the company, so has a vested (ie self-interest) in Holstein Ltd's profitability.

Prior to the adjustments which are needed, assets were 166% of liabilities, so above the required 150%. After the adjustments assets are only 90% of liabilities, which would mean that the bank is likely to call in its loan. This adds weight to the possibility that Ryan has deliberately not followed the correct IFRS financial reporting treatment so as to keep assets above the 150%.

IFRS is quite clear on the appropriate treatment of these four issues. Other than the presentational choice with regard to the government grant, there is no choice or judgement on any of the matters. I should not allow myself to be associated with financial statements that are contrary to IFRS. There may also be an intimidation threat since Ryan is my superior and a significant shareholder in the company.

I should apply the ICAEW Code of Ethics, with the following programme of actions:

- Explain matters to Ryan, with supporting evidence so that the matters can be corroborated.
- If resolution cannot be achieved, discuss the matters with the other directors to explain the situation and obtain support.
- Obtain advice from the ICAEW helpline or local members responsible for ethics.

During the resolution process it would be useful to keep a written record of all discussions, who else was involved and the decisions made.

Most candidates picked up a good number of the available marks for this part recognising the self- interest threat to Ryan arising from his significant shareholding in the company and the loan covenant (with a pleasing number attempting to illustrate the impact of the errors made on the requirement to maintain total assets at a minimum of 150% of total liabilities). Fewer picked up on the intimidation threat to the financial controller. Virtually all candidates suggested discussing the issues with Ryan, other directors and the ICAEW helpline. Sometimes suggestions were a little inappropriate such as demanding that Ryan go on a professional update course. As always there were a small minority of candidates who answered the question from the perspective of the external auditors and/or who thought that money laundering was the main issue.

Total possible marks	11½
Maximum full marks	5

Question 3

Total Marks: 21

General comments
Part (a) of this question required the calculation of the profit on disposal of a subsidiary. Part (b) tested the preparation of a consolidated statement of cash flows and supporting note, including the subsidiary disposed of during the year. Missing figures to be calculated included the profit before tax of the subsidiary, dividends paid (to the group and to the non-controlling interest), finance lease liabilities paid, income tax paid, additions to property, plant and equipment, and proceeds from the issue of share capital. Part (c) required consideration of the different users of the financial statements and the type of decisions they make.

Appaloosa plc

(a) Profit on disposal of Connemara Ltd

	£	£
Selling price		590,000
Less: Carrying amount of good will at date of disposal		
Consideration transferred	350,000	
NCI at acquisition ((100,000 + 226,000) x 30%)	97,800	
Less: Net assets at acquisition (100,000 + 226,000))	(326,000)	
Goodwill at acquisition	121,800	
Less: Impairment to date	(50,000)	
		(71,800)
Less: Carrying amount of net assets at date of disposal		(734,200)
Add back: NCI in net assets at date of disposal (734,200 x 30%)		220,260
		4,260

A significant number of candidates calculated this figure correctly. Others arrived at the correct figure for goodwill, but made errors in the remainder of the calculation. The most common errors were using incorrect figures for the net assets disposed of and/or acquired.

Total possible marks	3½
Maximum full marks	2

(b) Consolidated statement of cash flows for the year ended 30 June 2014

	£	£
Cash flows from operating activities		
Cash generated from operations (Note)	1,535,240	
Interest paid	(51,300)	
Income tax paid (W3)	(362,600)	
Net cash from operating activities		
Cash flows from investing activities		1,121,340
Purchase of property, plant and equipment (W4)	(1,168,500)	
Disposal of Connemara Ltd net of cash disposed of (590,000 – 13,800)	576,200	
Net cash used in investing activities		(592,300)
Cash flows from financing activities		
Proceeds from share issues (W6)	160,000	
Repayment of finance lease liabilities (W2)	(467,800)	
Dividends paid (W7)	(100,300)	
Dividends paid to non-controlling interest (W8)	(72,940)	
Net cash used in financing activities		(481,040)
Net increase in cash and cash equivalents		48,000
Cash and cash equivalents at beginning of period		53,500
Cash and cash equivalents at end of period		101,500

Note: Reconciliation of profit before tax to cash generated from operations

	£
Profit before tax (1,538,300 + 92,840 (W1))	1,631,140
Finance cost	51,300
Depreciation charge	561,500
Increase in inventories (1,785,900 – 1,025,100)	(760,800)
Increase in trade and other receivables ((725,200 + 57,900) – 699,800)	(83,300)
Increase in trade and other payables ((582,500 + 42,700) – 489,800)	135,400
Cash generated from operations	1,535,240

Workings

(1) Profit before tax of subsidiary

	£
Profit from discontinued operations per Q	77,500
Add back: Income tax expense	19,600
Less: Profit on disposal (a)	(4,260)
	92,840

(2) Finance lease liabilities

	£		£
Cash (β)	467,800	B/d (270,000 +148,200)	418,200
C/d (350,200 +150,200)	500,400	PPE	550,000
	968,200		968,200

(3) Income tax

	£		£
Cash (β)	362,600	B/d	378,000
C/d	420,000	CP&L (385,000 + 19,600)	404,600
	782,600		782,600

(4) Non-current assets

	£		£
B/d	2,478,000	Disposal of sub – PPE	705,200
Revaluation (W5)	356,500	Depreciation charge	561,500
Finance leases	550,000	Disposal of sub – GW (W1)	71,800
Additions (β)	1,168,500	C/d	3,214,500
	4,553,000		4,553,000

(5) Revaluation surplus

	£		£
		B/d	423,000
C/d	779,500	PPE (β)	356,500
	779,500		779,500

(6) Share capital and premium

	£		£
		B/d (400,000 + 40,000)	440,000
C/d (500,000 + 100,000)	600,000	Cash received (β)	160,000
	600,000		600,000

(7) Retained earnings

	£		£
Dividends in SCE (β)	100,300	B/d	1,364,800
C/d	2,279,800	CP&L	1,015,300
	2,380,100		2,380,100

(8) Non-controlling interest

			£
Cash (β)	72,940	B/d	742,600
Disposal (734,200 x 30%)	220,260		
C/d	664,900	CP&L	215,500
	958,100		958,100

Candidates performed slightly better than they did last time the preparation of a consolidated statement of cash flows was examined (also featuring the disposal of a subsidiary). Although the disposal element of the question would be expected to cause some problems, at this sitting candidates seemed to struggle with even the basics such as arriving at figures for tax paid and interest paid, calculations which are tested at Certificate Level. Many candidates displayed a poor grasp of the fundamentals of double-entry bookkeeping when calculating individual cash flow figures. Those candidates who did not use a T-account approach tended to produce confusing and less structured workings, which had a detrimental impact on the marks earned. Most candidates set out the statement in a reasonably clear way and therefore gained presentation marks. However, a number of candidates lost marks for not providing sub-totals for the different categories of cash flows. Most candidates made a good attempt at the reconciliation of profit before tax to cash generated from operations. The majority of candidates gained over half marks on this with the most common error being not to add in the profit before tax for the discontinued operation. Other common errors were to not make adjustments for the discontinued operation in the movement in trade receivables and payables. Treatment of the disposal of the subsidiary was mixed, with weaker candidates either omitting the impact of the disposal or adjusting for it in the incorrect direction. Only the very best candidates calculated the profit before tax of the subsidiary then used this figure in their reconciliation note, although some others adjusted for the profits for discontinued operations per the question and/or their profit on disposal from Part (a). The proceeds from the share issue and the net cash impact of the disposal were almost always correctly calculated and a significant majority also correctly calculated the dividend paid by Appaloosa plc. Generally, candidates made a reasonable attempt at the property, plant and equipment T-account and the dividend paid to the non-controlling interest There was no specific recurring error in the property, plant and equipment T-account; it was more that candidates missed one (or more) of the figures. In the non-controlling interest T-account candidates generally missed the disposal figure. The finance lease liability calculation seemed to cause candidates the most problems (other than adjusting for the disposal of the subsidiary).	
Total possible marks Maximum full marks	16 14

(c) User groups and the decisions they need to make

Present and potential investors

- Likely risk and return of investment/potential investment
- Ability of entity to pay dividends

Employees

- Employer's stability and profitability
- Ability of employer to provide remuneration/employment opportunities/retirement and other benefits

Lenders

- Whether loans and interest can be repaid when due

Suppliers and other trade payables

- Likelihood of being paid when due

Customers

- Whether the entity will continue in existence

Governments and trade agencies

- How to allocate central resources
- How best to regulate activities
- Taxation due
- Basis for national statistics

The public

- Trends and recent developments in prosperity/activities
- Likely impact on local economy

Whilst most candidates came up with five user groups, some of them were too similar to warrant separate marks (for example, existing and potential investors were marked as one user group, as were directors and management) and the information given re the decisions these groups might make were too often extremely brief, consisting of two or three words. Other candidates cited decisions which were not likely to be made from the published financial statements (for example, lending banks would be unlikely to be interested in historic, as opposed to prospective, cash flows). Frequently, candidates could have chosen better user groups, in order to allow them to write more about the decisions of those groups. For example, whilst management could be considered a user group it is difficult to see what information they would usefully gain from the financial statements to make decisions when they have full access to management accounts which are already tailored to their needs. Nonetheless the mark plan was flexible, and if sensible comments were made, marks were awarded.

Total possible marks Maximum full marks	7½ 5

Question 4

Total Marks: 22

General comments

Part (a) of this question required the calculation of a revised gain on bargain purchase where errors had been made in the original calculation. Part (b) required the preparation of a consolidated statement of profit or loss. The group had two subsidiaries, one of which was acquired during the year, and an associate. The question featured fair value adjustments, including some to be made to the gain on bargain purchase, inter-company trading and impairment of goodwill. Part (c) tested the differences between IFRS and UK GAAP with respect to the financial reporting treatment followed in Parts (a) and (b).

Oldenburg plc

(a) Revised gain on bargain purchase

			£
Gain on bargain purchase per Q			35,000
Add:	Professional fees wrongly included in consideration	8,000	
	FV adjustment to building (W1)	22,000	
Less:	Contingent liability	(36,500)	
			(6,500)
Less:	Adj to NCI (W2)		(6,250)
			22,250

Workings

(1) Fair value adjustment to building

	£
Fair value on 1 October 2013	154,000
Carrying amount at 1 October 2013 (300,000 – ((300,000) ÷ 25) x 14)	(132,000)
	22,000

(2) Adjustment to NCI

	£
Original NCI on proportionate basis (500,000 + 35,000) x 20/80))	133,750
NCI at FV	(140,000)
	(6,250)

This part of the question caused a significant amount of confusion. However, a number of candidates presented clear answers to this part and gained full marks.

Candidates seemed to struggle with the concept that they had to unpick the accounting that had taken place. They often presented a random set of calculations which mirrored their thought processes but never arrived at a final figure. For example, candidates often knew that they had to adjust for the professional fees but didn't know whether they should add or subtract those fees. The calculation could have been attempted in two ways; either by adjusting the calculated figure or starting again, and both approaches were marked in a consistent manner. However, a significant number of candidates used a combination of both approaches and therefore often double counted their adjustments.

Candidates generally adjusted for the contingent liability and the fair value adjustment although where these adjustments were made was less clear. The adjustment to the non-controlling interest was often simply not calculated. Many correctly calculated the fair value adjustment to the building but then failed to use that figure. Others also calculated the related depreciation adjustment in this part but then failed to use it in Part (b). Where this was the case later credit was given for that calculation.

Total possible marks	5½
Maximum full marks	5

(b) Consolidated statement of profit or loss for the year ended 30 June 2014

	£
Revenue (W1)	5,434,000
Cost of sales (W1)	(3,671,850)
Gross profit	1,762,150
Operating expenses (W1)	(1,135,350)
Profit from operations	626,800
Share of profit of associate (W4)	9,804
Profit before tax	636,604
Income tax expense (W1)	(190,200)
Profit for the period	446,404
Profit attributable to	
Owners of Oldenburg plc (β)	407,664
Non-controlling interest (W3)	38,740
	446,404

Workings

(1) Consolidation schedule

	Oldenburg plc	**Zangersheide Ltd**	**Westphalian Ltd 9/12**	**Adj**	**Consol**
	£	**£**	**£**	**£**	**£**
Revenue	2,978,500	1,759,500	982,800	(286,800)	5,434,000
Cost of sales – per Q	(2,100,600)	(1,198,500)	(655,950)	286,800	
– PURP (W2)		(23,900)			
– PPE PURP ((567,000 – 465,500) x 20%)		20,300			(3,671,850)
Op expenses – per Q	(701,600)	(203,500)	(225,000)		
– prof fees re acquisition	(8,000)				
– additional deprec on building ((22,000 ÷ 11) x 9/12)			(1,500)		
– GW impairment	(18,000)				
– Gain on BP (a)	22,250				(1,135,350)
Tax	(53,000)	(107,200)	(30,000)		(190,200)
		246,700	70,350		

(2) PURPs

	%	**Zangersheide Ltd £**	**Hanoverian Ltd £**
Sales	120	286,800	101,040
Cost of sales	(100)	(239,000)	(84,200)
GP	20	47,800	16,840
x ½		23,900	8,420
x 30%			2,526

(3) Non-controlling interest in year

	£
Zangersheide Ltd (10% x 246,700 (W1))	24,670
Westphalian Ltd (20% x 70,350 (W1))	14,070
	38,740

(4) Share of profit of associate

	£
Share of PAT (61,100 x 30%)	18,330
Less: Impairment	(6,000)
PURP (W2)	(2,526)
	9,804

Candidates generally made a good attempt at the preparation of the consolidated statement of profit or loss. Most statements were reasonably presented with most candidates gaining some marks for presentation. Candidates usually produced a consolidation schedule as part of their workings and those that did tended to gain the most marks as workings and figures were clear.

The two inventory PURP figures were usually correctly calculated, although some candidates forgot that one of these needed adjusting to reflect only the associate share or that it should have been set against the share of profit of associate figure rather than against the consolidated cost of sales figure. The property, plant and equipment PURP was often correctly calculated, but then either not used or adjusted for in the wrong direction or wrong column in the consolidation schedule.

It was disappointing to see just how many candidates made the very basic error of using the parent's percentage rather than the non-controlling interest percentage when calculating the figure for non-controlling interest in the year. However, most did use the figures from the subsidiaries' columns in their consolidation schedule in their calculation of this figure, although some used the figures from the question without adjustment or with adjustments which failed to mirror what they had done elsewhere in their answer, thereby failing to gain the marks for this calculation.

Candidates generally made a reasonable attempt at the share of profit in the associate, with mnay calculating the correct figure. Where errors were made the most common were not adjusting for the PURP, as highlighted above, or multiplying all figures by the 30% interest (including the impairment and often the PURP figure twice).

The three most common errors were to omit the revised gain on bargain purchase, the adjustment for the professional fees and/or the additional depreciation on the building, even where these figures had been calculated in Part (a).

Total possible marks Maximum full marks	16 14

(c) IFRS v UK GAAP differences

Under UK GAAP (FRS 7) acquisition-related costs are added to the cost of the investment in the subsidiary and therefore affect the calculation of goodwill arising on consolidation. IFRS 3 recognises acquisition-related costs as an expense in profit or loss as incurred.

UK GAAP (FRS 10) recognises negative goodwill as a separate item within goodwill. This is subsequently recognised in the profit and loss account in the periods in which the non-monetary assets are recovered, whether through depreciation or sale. IFRS 3 requires immediate recognition of negative goodwill ("gain on bargain purchase") as a gain in profit or loss.

Under UK GAAP (FRS 10) goodwill is amortised over its estimated useful economic life, with a rebuttable presumption that this is not more than 20 years. Under IFRS 3 goodwill is subject to annual impairment reviews.

UK GAAP (FRS 9) requires the investor's share of the associate's operating results, exceptional items, interest, profit before tax and tax to be separately disclosed. IAS 28, Investments in Associates and Joint Ventures, merely requires the investor's share of the profit or loss of an associate to be disclosed.

Under UK GAAP (FRS 6) the non-controlling interest is always measured using the proportionate (share of net assets) method. IFRS3 allows the proportionate method or the fair value method.

Answers to this part of the question were very varied, with many candidates gaining full marks and others failing to attempt this requirement at all. Answers on UK GAAP differences continue to be quite varied. Candidates need to be very careful in these requirements as many simply write something without identifying whether it is the treatment under UK GAAP or IFRS, or explain one treatment and then say this isn't allowed under the other basis without explaining what the alternative treatment is. A minority of candidates included differences that were of no relevance to the earlier parts of the question.

Total possible marks Maximum full marks	6½ 3

PROFESSIONAL LEVEL EXAMINATION

MONDAY 9 JUNE 2014

(3 hours)

FINANCIAL ACCOUNTING AND REPORTING

This paper consists of **FOUR** written test questions (100 marks).

1. Ensure your candidate details are on the front of your answer booklet.
2. Answer each question in black ball point pen only.
3. Answers to each written test question must begin on a new page and must be clearly numbered. Use both sides of the paper in your answer booklet.
4. The examiner will take account of the way in which answers are presented.

Unless otherwise stated, make all calculations to the nearest month and the nearest £.

All references to IFRS are to International Financial Reporting Standards and International Accounting Standards.

IMPORTANT Question papers contain confidential information and must NOT be removed from the examination hall. **DO NOT TURN OVER UNTIL YOU ARE INSTRUCTED TO BEGIN WORK**	You MUST enter your candidate number in this box. | | | | |

1. The following trial balance has been extracted from the nominal ledger of Tipperary plc at 31 December 2013.

	Note(s)	£	£
Sales	(2), (3)		5,709,600
Purchases		3,968,600	
Administrative expenses		1,097,900	
Distribution costs		562,700	
Land and buildings	(1)		
Valuation (on 1 January 2011)		500,000	
Accumulated depreciation at 31 December 2012			80,000
Plant and equipment	(1), (2)		
Valuation (on 1 January 2011)		175,000	
Accumulated depreciation at 31 December 2012			70,000
Retained earnings at 31 December 2012			256,450
Revaluation surplus at 31 December 2012	(1)		209,000
Ordinary share capital (£1 shares)	(3)		230,000
Redeemable preference share capital 2015 (£1 shares)	(3)		100,000
Bank account			57,850
Trade and other receivables		363,750	
Trade and other payables			233,050
Inventories at 31 December 2012	(4)	278,000	
		6,945,950	6,945,950

The following additional information is available:

(1) Tipperary plc measures its property, plant and equipment under the revaluation model. On 1 January 2013 the company's land and buildings were valued at £450,000 (land £100,000) and its plant and equipment at £85,000. This valuation has not been reflected in the trial balance above.

On 1 January 2013 the remaining useful lives of the buildings and plant and equipment were reassessed at 20 years and four years respectively. Depreciation on buildings should be presented in administrative expenses and depreciation on plant and equipment should be presented in cost of sales. Other than the equipment referred to in Note (2) below, there were no additions to or disposals of property, plant and equipment in the year ended 31 December 2013. The revaluation surplus at 31 December 2012 included £200,000 in respect of land and buildings, with the remainder attributable to plant and equipment.

Tipperary plc has a policy of making an annual transfer between the revaluation surplus and retained earnings wherever possible. Depreciation charges for the year ended 31 December 2013 on a historical cost basis would have been £15,000 for plant and equipment and £10,000 for buildings.

(2) On 1 January 2013 Tipperary plc acquired new equipment for £30,000, which is included in the £175,000 in the trial balance and in the valuation of £85,000 in Note (1) above. A government grant of £18,000 was received to help finance the purchase of this equipment as part of the government's drive to encourage investment in new technology, and was credited to sales. Tipperary plc has an accounting policy of using the deferred income approach.

(3) The redeemable preference shares were issued on 1 January 2013, and the coupon and effective interest rates are both 5%.

On 15 February 2013 Tipperary plc declared an ordinary dividend of 10p per share in respect of the year ended 31 December 2012. This was paid one month later and debited to administrative expenses.

On 30 June 2013 Tipperary plc made a 1 for 4 rights issue of ordinary shares at a price of £1.20 per share. The rights issue was fully taken up. The nominal value received was credited to ordinary share capital, but the premium was credited to sales.

No ordinary or preference dividends have been paid or accrued in respect of the current year.

(4) Inventories at 31 December 2013 have been valued at £192,300. During the inventory valuation it was discovered that inventories at 31 December 2012 had, in error, been overvalued by £100,000.

(5) On 15 November 2013 Tipperary plc purchased some inventories from an overseas supplier for €115,000, correctly recording the transaction at that date, but making no further adjustments. The invoice was unpaid at 31 December 2013. The spot exchange rates are as follows:

15 November 2013 €1:£0.90
31 December 2013 €1:£0.85

(6) The income tax liability for the current year has been estimated at £10,500.

Requirements

(a) Prepare the following for the financial statements of Tipperary plc for the year ended 31 December 2013, in a form suitable for publication:

(i) a statement of profit or loss
(ii) a statement of financial position
(iii) a statement of changes in equity (a total column is **not** required). **(22 marks)**

NOTES: Notes to the financial statements are not required.
Expenses should be analysed by function.

(b) Describe the alternative treatment of the government grant set out in Note (2) above, comparing this to the treatment adopted by Tipperary plc, and quantifying the effect on the financial statements of Tipperary plc for the year ended 31 December 2013. **(4 marks)**

(c) According to the IASB Conceptual Framework, users require information regarding financial position, financial performance and changes in financial position.

Explain how the information contained in financial statements in respect of property, plant and equipment meets those information needs. **(5 marks)**

(31 marks)

2. You are an ICAEW Chartered Accountant employed as the financial controller at Limerick plc, a UK listed company. You have recently returned from maternity leave to find that the finance director (another ICAEW Chartered Accountant) has resigned and left the company, following his concerns over accounting practices he was being asked to implement. In your absence, the managing director, who is not a qualified accountant, has drafted financial statements for the year ended 31 December 2013. The managing director summoned you to his office and explained the situation to you:

"As you know, Limerick plc has been in difficulties for some time and after disappointing results for the year ended 31 December 2012, the board of directors is keen to report as high a profit as possible for the year ended 31 December 2013. In particular, I want to show the board that the company's basic earnings per share has improved significantly on last year's figure of 70.3p.

Whilst you were away I have drafted the financial statements for the year ended 31 December 2013 and need you to confirm that they are suitable for publication. Can you also check that I have correctly calculated basic earnings per share at 500.5p? I based this on earnings of £500,500 and the 100,000 £1 ordinary shares in issue on 1 January 2013. If you can confirm my figures you could be our next finance director."

On examining the draft financial statements prepared by the managing director, you identify the following matters of concern:

(1) On 1 January 2013 Limerick plc entered into a 40 year lease for land and buildings. Ownership of both the land and the buildings passes to Limerick plc at the end of the lease term. The lease payments are £120,000 pa, paid annually in advance. The managing director has treated the entire lease as an operating lease on the grounds that the land has an indefinite economic life and so Limerick plc is not leasing the land over the majority of its economic life. The buildings have an estimated useful life of 42 years. Limerick plc depreciates buildings on a straight-line basis.

Having made further enquiries you have established that the fair value of the leasehold interest is £1.3 million, of which £110,000 relates to land. The interest rate implicit in the lease is 10% pa. The present value of the minimum lease payments in relation to the buildings is £1,183,265, and in relation to the land is £107,570.

(2) On 1 January 2013 Limerick plc had purchased a recycling plant for £260,000, in order to process hazardous waste generated as a by-product of its other operations. The plant has an estimated useful life of five years after which it is expected to be superseded by new technology. The plant was capitalised at £260,000 and the managing director has correctly calculated depreciation based on that figure. However, he has not made any accounting entries in respect of the cost of decommissioning the plant at the end of the five year period of operation, which was a condition of the purchase, and which you have established is expected to cost £50,000.

(3) Limerick plc's building division buys land, and builds and fits out retail outlets which are then sold. On 1 January 2013 this division sold a plot of building land to an unconnected company for £750,000 when the market value of the land was £1 million. The plot had originally been acquired for £500,000. Limerick plc retains the right to build on this land until 31 December 2014 when it has the right to buy the plot back for £858,675. The managing director has recognised the profit on the sale of the land in the statement of profit or loss for the year ended 31 December 2013. You have seen emails between the directors of Limerick plc indicating that the company is likely to repurchase the land.

(4) The managing director included a note to the financial statements for the year ended 31 December 2013 regarding a contingent liability relating to a court case against Limerick plc which was in progress at the year end. On 15 February 2014 the judge in the case ruled against Limerick plc and the company was ordered to pay damages of £100,000 to the claimants and legal costs of £25,000. The managing director has not accrued for this amount in the financial statements for the year ended 31 December 2013 on the grounds that the judgment was not made until after the year end.

On 1 July 2013 Limerick plc made a 1 for 4 bonus issue of ordinary shares, and on 1 October 2013 issued a further 80,000 ordinary shares at full market price.

Requirements

(a) Explain the required IFRS financial reporting treatment of the four issues above in the financial statements for the year ended 31 December 2013, preparing all relevant calculations. Unless stated otherwise, an applicable discount rate is 7% pa. **(18 marks)**

(b) Using your results from Part (a) calculate revised earnings and basic earnings per share for the year ended 31 December 2013. Your answer should include an explanation of why the managing director was incorrect to base his calculation on the number of ordinary shares in issue at the beginning of the year. **(6 marks)**

(c) Discuss the ethical issues arising from the scenario and the steps that you should take to address them. **(5 marks)**

(29 marks)

3. Laois plc has investments in two companies, Carlow Ltd and Kerry Ltd and recognises goodwill and non-controlling interest using the fair value method.

The draft, summarised statements of financial position of the three companies at 31 December 2013 are shown below:

	Laois plc £	Carlow Ltd £	Kerry Ltd £
ASSETS			
Non-current assets			
Property, plant and equipment	2,687,000	2,196,000	591,800
Investments	1,760,000	–	–
Goodwill	–	–	24,000
	4,447,000	2,196,000	615,800
Current assets			
Inventories	193,200	53,700	159,000
Trade and other receivables	288,000	92,300	207,000
Cash and cash equivalents	15,800	12,400	1,100
	497,000	158,400	367,100
Total assets	4,944,000	2,354,400	982,900
EQUITY AND LIABILITIES			
Equity			
Ordinary share capital (£1 shares)	2,000,000	650,000	360,000
Share premium account	750,000	300,000	–
Retained earnings	1,645,400	1,078,600	176,000
	4,395,400	2,028,600	536,000
Current liabilities			
Trade and other payables	398,600	220,800	436,400
Taxation	150,000	105,000	10,500
	548,600	325,800	446,900
Total equity and liabilities	4,944,000	2,354,400	982,900

Additional information:

(1) Laois plc acquired 80% of the 650,000 ordinary shares of Carlow Ltd for cash of £1,560,000 on 1 January 2009 when the retained earnings of Carlow Ltd were £592,000. The fair values of the assets, liabilities and contingent liabilities of Carlow Ltd at this date were equal to their carrying amounts, with the exception of a property which had a fair value £200,000 in excess of its carrying amount. The property had a remaining useful life of 25 years on the date that Laois plc acquired its shares in Carlow Ltd. The fair value of the non-controlling interest in Carlow Ltd on 1 January 2009 was £350,000.

(2) On 1 January 2013, Laois plc acquired 60% of the 360,000 ordinary shares of Kerry Ltd. The consideration consisted of cash of £200,000 paid on 1 January 2013 and a further cash payment of £104,000, deferred until 1 January 2014. An appropriate discount rate is 4% pa.

On 1 January 2013 Kerry Ltd's retained earnings were £240,000 and its statement of financial position included goodwill of £30,000 which had arisen on the acquisition of a sole trader. In the year ended 31 December 2013 an impairment of £6,000 was recognised by Kerry Ltd in relation to this goodwill.

The fair values of the other assets, liabilities and contingent liabilities were equal to their carrying amounts. The fair value of the non-controlling interest in Kerry Ltd on 1 January 2013 was £235,000. A reassessment of Kerry Ltd's assets, liabilities and contingent liabilities and consideration transferred took place following acquisition and no adjustments were necessary.

(3) Early in December 2013 Kerry Ltd recorded goods purchased from Carlow Ltd for £50,000. At the year end Kerry Ltd held half of these goods in its inventories. Carlow Ltd makes all sales at cost plus a mark-up of 25%.

In addition, on 30 December 2013 Carlow Ltd had dispatched goods to Kerry Ltd and raised the relevant sales invoice. These goods were not received by Kerry Ltd until 3 January 2014 and the related purchase invoice was not accrued for as at the year end. These goods in transit had originally been purchased by Carlow Ltd at a cost of £12,000.

No intra-group balances had been settled by the year end.

Requirement

Prepare the consolidated statement of financial position of Laois plc as at 31 December 2013.

(19 marks)

PLEASE TURN OVER

4. Kildare plc is a UK listed company, and has a number of investments in other companies. The following information has been extracted from Kildare plc's draft consolidated financial statements for the year ended 31 December 2013:

Consolidated statement of profit or loss (extract)

	£
Profit attributable to	
Owners of Kildare plc	865,800
Non-controlling interest	256,700

Consolidated statement of financial position (extract)

	£
Non-current assets	
Property, plant and equipment	2,752,100
Intangibles	356,000

Consolidated statement of cash flows (extract)

	£
Net cash used in investing activities	(50,600)

Kildare plc's draft retained earnings (single entity) were £109,700 at 31 December 2013.

The following matters have not yet been accounted for in the draft consolidated financial statements:

(1) On 1 January 2007 Kildare plc had acquired 70% of the 100,000 ordinary 50p shares of Sligo Ltd for £225,000 when the retained earnings of Sligo Ltd were £158,900. The fair values of the assets, liabilities and contingent liabilities of Sligo Ltd at this date were equal to their carrying amounts, with the exception of inventory, which had a carrying amount of £29,000 but a fair value of £35,000. The inventory was sold in July 2007.

On 30 June 2013 Kildare plc sold its holding in Sligo Ltd for cash of £300,000, when Sligo Ltd had cash and cash equivalents of £1,500, crediting the sale proceeds to a suspense account. On 31 December 2013 the retained earnings of Sligo Ltd were £275,000, including a profit for 2013 of £75,000, which had accrued evenly over the year. As at 31 December 2012 Kildare plc had recognised cumulative impairment losses of £40,000 in respect of goodwill acquired in the business combination with Sligo Ltd.

Kildare plc has not consolidated any amounts in respect of Sligo Ltd for the year ended 31 December 2013. The group accounting policy is to recognise goodwill and non-controlling interest using the proportionate method.

(2) On 1 January 2012 Kildare plc had entered into a joint venture, purchasing 40% of the 200,000 ordinary £1 shares of Mayo Ltd at par. In the year ended 31 December 2013 Mayo Ltd made a profit of £48,400 (2012 £52,800) and made sales of £120,000 to Kildare plc, at a gross profit margin of 25%. Kildare plc held half of these goods in its inventory at 31 December 2013. On 31 December 2013 Kildare plc received a dividend of £10,000 from Mayo Ltd. The dividend was credited to a suspense account.

(3) During the year ended 31 December 2013, Kildare plc spent £275,000 on the research and development of a new product that is believed to be commercially viable, although it is still currently in its development stage. The £275,000 can be broken down as follows:

	£
Initial research costs	50,000
Evaluation of research findings	20,000
Patent registration costs	5,000
Specialised equipment needed for the development process	90,000
Qualifying development costs	110,000
	275,000

Kildare plc has debited these amounts to a suspense account. The useful life of the specialised equipment is estimated to be three years. The equipment is to be depreciated on a straight-line basis over that period starting on 1 July 2013, when the equipment was first used in the development process.

Requirements

(a) Prepare revised extracts from Kildare plc's consolidated financial statements for the year ended 31 December 2013 showing profit attributable to the owners of Kildare plc and to the non-controlling interest, non-current assets, and net cash from investing activities. **(12 marks)**

(b) Describe any differences between IFRS and UK GAAP in respect of the financial reporting treatment of all of the above issues. **(4 marks)**

(c) Calculate the amount of Kildare plc's distributable profits at 31 December 2013, explaining your calculation. **(5 marks)**

(21 marks)

NOTES: Ignore the impact of taxation on the above issues.
The preparation of disclosure notes is not required.

MARK PLAN AND EXAMINER'S COMMENTARY

The marking plan set out below was that used to mark this question. Markers were encouraged to use discretion and to award partial marks where a point was either not explained fully or made by implication. More marks were available than could be awarded for each requirement. This allowed credit to be given for a variety of valid points which were made by candidates.

Question 1

Total Marks: 31

General comments

Part (a) of this question tested the preparation of a statement of profit or loss, a statement of financial position and a statement of changes in equity from a trial balance plus a number of adjustments. Adjustments included the revaluation of property, plant and equipment (with a transfer between the revaluation surplus and retained earnings), the receipt of a government grant, share issues and dividends, a foreign exchange transaction and a prior period adjustment. Part (b) required an explanation and quantification of the alternative treatment of the government grant. Part (c) tested the information needs of users in the context of property, plant and equipment.

Tipperary plc

(a) Financial statements

Statement of profit or loss for the year ended 31 December 2013

	£
Revenue (5,709,600 – 18,000 – 9,200 (SCE))	5,682,400
Cost of sales (W1)	(3,976,300)
Gross profit	1,706,100
Distribution costs (W1)	(562,700)
Administrative expenses (W1)	(1,097,000)
Profit from operations	46,400
Finance cost (100,000 x 5%)	(5,000)
Profit before tax	41,400
Income tax expense	(10,500)
Profit for the year	30,900

Statement of financial position as at 31 December 2013

	£	£
Assets		
Non-current assets		
Property, plant and equipment (535,000 (W2) – 21,250 – 17,500 (W1))		496,250
Current assets		
Inventories	192,300	
Trade and other receivables	363,750	
		556,050
Total assets		1,052,300

Equity and liabilities	**£**	**£**
Equity		
Ordinary share capital		230,000
Share premium		9,200
Revaluation surplus		222,500
Retained earnings		176,450
		638,150
Non-current liabilities		
Preference share capital (5% redeemable)	100,000	
Deferred income (13,500 – 4,500) (W3)	9,000	
		109,000
Current liabilities		
Bank overdraft	57,850	
Trade and other payables (233,050 + 5,000 – 5,750 (W4))	232,300	
Deferred income (W3)	4,500	
Taxation	10,500	
		305,150
Total equity and liabilities		1,052,300

Statement of changes in equity for the year ended 31 December 2013

	Ordinary share capital	*Share premium*	*Revaluation surplus*	*Retained earnings*
	£	**£**	**£**	**£**
At 1 January 2013	184,000	-	209,000	256,450
Prior period error	-	-	-	(100,000)
Restated balance	184,000	-	209,000	156,450
Rights issue (230,000 ÷ 5) (x 20p)	46,000	9,200	-	-
Total comprehensive income for the year (30,000 – 9,000 (W2))	-	-	21,000	30,900
Transfer to retained earnings (17,500 (W1) – 10,000)	-	-	(7,500)	7,500
Ordinary dividend (184,000 x 10p)	-	-	-	(18,400)
At 31 December 2013	230,000	9,200	222,500	176,450

Workings

(1) Costs matrix

	Cost of sales	*Distrib costs*	*Admin expenses*
	£	**£**	**£**
Per TB	3,968,600	562,700	1,097,900
Downwards revaluation (W2)	11,000		
Depreciation (85,000/4) ((450,000 – 100,000)/20)	21,250		17,500
Opening inventories (278,000 – 100,000)	178,000		
Closing inventories	(192,300)		
Ordinary dividend			(18,400)
Release of government grant (W3)	(4,500)		
Exchange gain (W4)	(5,750)		
	3,976,300	562,700	1,097,000

Note: Marks were awarded if items were included in different line items than the above provided that the heading used was appropriate.

(2) PPE and revaluation reserve

	Land and buildings	*Plant and equipment*	
	£	**£**	**£**
Carrying amount at 1 January 2013	420,000	105,000	
Valuation on 1 January 2013	450,000	85,000	535,000
Revaluation upwards/(downwards)	30,000	(20,000)	
Revaluation surplus at 1 January 2013		9,000	209,000
To statement of profit or loss		(11,000)	

(3) Government grant

Grant received	18,000
Less: Released in year (18,000/4)	(4,500)
Deferred income	13,500

(4) Forex transaction

Translation on 15 November 2013 (€115,000 x 0.90)	103,500
Translation on 31 December 2013 (€115,000 x 0.85)	97,750
Exchange gain	5,750

Candidates generally performed well on this part of the question. Presentation of the three statements was usually of a sufficient standard to collect the available presentation marks with the presentation and indeed completion of the statement of changes in equity (which candidates often find more challenging) of a pleasing standard. Many candidates, however, failed to take their closing balances from this statement to the equity section of their statement of financial position, thereby letting the statement of changes in equity act as a working for those figures, and instead wasted time by producing other workings for these figures. On occasion, the figures in these additional workings and those in the statement of changes in equity were different. Only a minority of candidates failed to produce a statement of changes in equity.

The statement of profit or loss was generally well prepared and completed by the majority of candidates. It was pleasing to see that the majority of candidates also prepared a cost matrix working. By preparing this standard working candidates maximise the number of marks they will be awarded. Haphazard cost workings, or brackets on the face of the statement of profit or loss (which were used by a minority of candidates) often lost marks through missing narrative and no audit trail.

The majority of candidates correctly reduced opening inventory for the overvaluation in the cost matrix however a minority instead adjusted closing inventory, which whilst having the same effect in the cost matrix meant that closing inventory in the statement of financial position was incorrect. The overvaluation was reflected in the statement of changes in equity by a significant number of candidates although considerably less showed it in the correct place and then showed a sub-total with a restated balance. Others made the adjustment in the statement of changes in equity but then failed to reduce opening inventories in the cost matrix.

The government grant was generally dealt with correctly by the majority of candidates in the statement of financial position, although less showed the correct figure as an adjustment to revenue and/or the release of the grant in the year as a deduction from expenses (or as operating income). Similarly the exchange gain was correctly calculated by almost all candidates and a significant number correctly reduced trade and other payables, but again less went on to reflect the adjustment correctly in the statement of profit or loss.

The property, plant and equipment working caused problems for a number of candidates, who omitted to revise the balances in the trial balance for the revaluation. Many candidates, though not all, realised that the downwards revaluation on the plant and equipment needed to be split between the statement of profit or loss and the revaluation surplus (although having recognised this not all of these candidates then followed this through to their cost matrix and the statement of changes in equity). Fewer still realised that, since the latter transfer had wiped out that part of the revaluation surplus which related to plant and equipment, the only transfer that could be made for the additional depreciation was that arising from the revaluation of the buildings.

Other common errors included the following:

- Showing the bank balance (which was an overdraft as shown by its inclusion on the credit side of the trial balance in the question) in current assets instead of in current liabilities.
- Not showing the net revaluation in the year and the profit for the year on a single line in the statement of changes in equity, described as "total comprehensive income".
- Showing £230,000 as the opening balance on ordinary share capital in the statement of changes in equity, as opposed to the closing balance (and then working backwards from that to adjust for the rights issue).
- Failing to split the deferred grant between current and non-current liabilities.
- Being careless with the bracket convention in the cost matrix, for example showing closing inventory or the foreign currency gain as increases rather than decreases in costs.
- Depreciating the land as well as the buildings.

Total possible marks	24½
Maximum full marks	22

(b) Alternative treatment of the government grant

The alternative method per IAS 20, Accounting for Government Grants is the netting-off approach. The netting-off approach requires the grant to be deducted in arriving at the carrying amount of the asset.

Under the netting-off approach the grant of £18,000 would have been credited to the cost of plant and machinery, giving an initial carrying amount of £12,000 (30,000 – 18,000), compared to an initial carrying amount in Part (a) of £30,000.

Depreciation would then have been charged on that net amount, giving a charge for the year of £3,000 (12,000/4) compared to a figure in Part (a) of £7,500 (30,000/4).

The final carrying amount would then be £9,000 (12,000 – 3,000) compared to £22,500 (30,000 – 7,500).

This decrease of £4,500 in the depreciation charge reflects the fact that under the netting-off method the grant is recognised in profit and loss over the life of the depreciable asset – "replacing" the credit of £4,500 in Part (a) where the grant is released directly into cost of sales.

The reduction of £13,500 in the final carrying amount "replaces" the total deferred income on the statement of financial position in Part (a) of £13,500.

The net effect on profit of the two methods is in fact the same as the different "treatments" are really a difference of presentation.

Almost all candidates knew that the alternative treatment of the government grant was the "netting off method" and correctly calculated the figures (cost, depreciation charge and carrying amount) on that basis. Fewer candidates compared these figures to those they had calculated in Part (a). Most stated that the figures "had the same net effect" but few described why this is in any detail.

Total possible marks	5½
Maximum full marks	4

(c) How information re PPE meets needs of users

Financial position

The financial position of an entity is affected by the economic resources it controls, its financial structure, its liquidity and solvency and its capacity to adapt to changes in the environment in which it operates.

Information about the total carrying amount of property, plant and equipment (PPE) as given on the face of an entity's statement of financial position gives the user an indication of the resources the entity has available to it in terms of tangible assets held for long-term use in the business. Revalued figures are more relevant than cost.

That figure will then be broken down further in the notes to the financial statements.
This indicates the *type* of PPE held which may add further to an understanding of resource. This note also shows the changes in financial position in the year.

For example, land and buildings might be held for investment potential as well as being used for office/factory space. Plant will be used to generate future revenues. Equipment could be used for the generation of future revenues or for the entity's own use, perhaps for administrative purposes.

The fact that the amount of leased assets forming part of the PPE figure is disclosed shows that these assets have a future cost in terms of lease payments – affecting the liquidity and solvency of the entity.

The "capital commitments" note showing the future purchases of PPE to which the entity is committed indicates a requirement for future finance.

The accounting policy note shows the valuation model used and depreciation methods, which allow comparison to other entities.

Financial performance

Information about financial performance, in particular profitability, is needed in order to assess potential changes in the economic resources that the entity is likely to control in the future.

Disclosure of the annual depreciation charge shows the "cost" of using the assets.

Disclosure of significant gains/losses on disposal could indicate problems with the depreciation method or where value is greater than carrying amount.

Impairment losses may indicate underlying issues, such as underprovision of depreciation, or a downturn in a particular market sector (which might affect future performance).

Changes in financial position

Changes in financial position are shown in the statement of cash flows. This allows users to assess the ability of the entity to generate cash and its need to use what is generated.

Users will be able to see, via the statement of cash flows, PPE purchased during the year and cash inflows from PPE disposed of. If little PPE is purchased and much disposed of then the user may be concerned about the future of the entity.

This part was dealt with much less well. The majority of candidates clearly struggled with this requirement, with a significant number gaining either one or zero marks (in spite of the fact that there is a very similar question in the revision question bank). A significant number of candidates simply discussed the qualitative characteristics in respect of property, plant and equipment, which was not asked for and gained no marks. Others made a series of "random" comments, with no attempt to link these to "financial position", "financial performance", "or "changes in financial position" as represented, per the Conceptual Framework, by the statement of financial position, the statement of profit or loss and the statement of cash flows.

Candidates must read requirements carefully and be mindful that unless the requirement is addressed they are wasting their time writing about something that they think might be relevant. It was not uncommon to see a whole page of writing gaining zero marks. Those candidates who scored the highest number of marks set up three headings (ie "financial position", "financial performance" and "changes in financial position") and made pertinent comments under each. There was, however, a common misconception, even amongst these candidates, that changes in financial position are shown by the statement of changes in equity. Another common error was to say that the statement of financial position showed cost less accumulated depreciation thereby showing what property, plant and equipment "is worth". Others referred to the performance of the asset, as opposed to the financial performance of the reporting entity.

Total possible marks	9½
Maximum full marks	5

Question 2

Total Marks: 29

General comments

Part (a) of this question required candidates to explain the financial reporting treatment of four accounting issues, given in the scenario. The issues covered a lease of land and buildings, decommissioning costs, sale and repurchase and an event after the reporting period. Part (b) required the calculation of revised earnings and basic EPS, having adjusted for errors made by the company as discussed in Part (a), plus an explanation of why the managing director's calculation was incorrect. Part (c) required an explanation of the ethical issues arising from the scenario and the action to be taken.

Limerick plc

(a) IFRS accounting treatment

(1) Lease of land and buildings

IAS 17, Leases, requires that the land and buildings elements of a single lease are considered separately in order to classify as a finance or an operating lease. A lease is classified as a finance lease if it transfers substantially all the risks and rewards incidental to the ownership of an asset.

The managing director (MD) is correct that land has an indefinite economic life. However, given the fact that ownership does pass, this lease is relatively long, and in the case of the buildings is for almost all of the asset's useful life, and in both cases the present value of the minimum lease payments amount to "substantially all" of the fair value of the asset, the whole lease should be treated as a finance lease.

As the MD has treated this as an operating lease then the payment of £120,000 made on 1 January 2013 will have been debited to expenses. This entry will need to be reversed. Per IAS 17, the finance lease should be capitalised at the lower of the fair value of £1.3 million and the present value of the minimum lease payments of £1,290,835 (1,183,265 + 107,570). The table below illustrates the entries which should have been made.

Year ended	*B/f*	*Payment*	*Capital*	*Interest at 10% pa*	*C/f*
	£	**£**	**£**	**£**	**£**
31 Dec 2013	1,290,835	(120,000)	1,170,835	117,084	1,287,919
31 Dec 2014	1,287,919	(120,000)	1,167,919		

A finance cost of £117,084 should be charged in the statement of profit or loss.

The lease liability at 31 December 2013 is therefore £1,167,919 non-current and £120,000 current.

Because legal title will pass, the building should be depreciated over its useful life of 42 years, giving a depreciation charge for 2013 of £28,173 (1,183,265 ÷ 42). The land is not depreciated. The carrying amount of the land and buildings in the statements of financial position at as 31 December 2013 will therefore be £1,262,662 (1,290,835 – 28,173).

(2) Decommissioning costs

Per IAS 37, Provisions, Contingent Liabilities and Contingent Assets, a provision should be recognised where:

- there is a present obligation as a result of a past event
- an outflow of resources is probable, and
- the amount can be estimated reliably.

The decommissioning costs meet these recognition criteria as:

- there is an obligation to decommission (it was a condition of the sale),
- it arose from a past event (the purchase of the plant), and
- there is a reliably estimated outflow of resources (the £50,000 that will be paid out).

When the plant was purchased on 1 January 2013, a provision should therefore have been made for the discounted costs of decommissioning the plant in five years' time, measured as £50,000 x $1/(1.07)^5$ = £35,649, adding this amount to the cost of the asset. This would also have had the effect of increasing the depreciation charge for 2013 on the asset by £7,130 (35,649 ÷ 5).

A finance cost of £2,495 (35,649 x 7%) should be charged in the year ended 31 December 2013 to reflect the unwinding of the discount and the provision should be increased by the same amount. In the statement of financial position as at 31 December 2013 the provision will be shown as a non-current liability of £38,144 (35,649 + 2,495).

(3) Sale and repurchase

This is a sale and repurchase agreement. Per IAS 18, Revenue, the terms and conditions of the sale need to be considered to determine whether or not there is a sale in substance. Where legal title has been transferred, but the risks and rewards of ownership (here the right to build on the land and potential gains and losses in market values) have been retained by the "seller" the transaction is treated as a financing arrangement. The fact that Limerick plc is likely to repurchase the land and at a price which is below the current market price adds weight to this conclusion.

The profit on the "sale" of the land of £250,000 (750,000 – 500,000) should therefore be derecognised. A loan of £750,000 and accrued finance cost of £52,500 (750,000 x 7%) should be recognised.

(4) Event after the reporting period

Per IAS 10, Events After the Reporting Period, the determination of the court case is an adjusting event as it provides evidence of conditions that existed at the end of the reporting period (ie of the court case that was already in progress). The financial statements should therefore be adjusted to include an accrual for the total due of £125,000 and the note re the contingent liability removed. There is no specific requirement to disclose the adjusting event.

Candidates generally performed well overall on this part of the question, although some issues were dealt with better than others. The majority of candidates responded to all four issues and provided both explanations and supporting calculations.

Issue (1): Most candidates made a good attempt at the lease of land and buildings, although there was clearly some confusion on this topic. Candidates generally understood that to assess which lease is present for land and buildings they needed to make the assessment separately. However, many candidates incorrectly identified the land as being an operating lease, even where they had noted that legal title passed. Where candidates did realise that both elements were finance leases they often split them out and produced two lease tables, which was unnecessary. However, this sometimes followed on from a statement that the two leases were to be "treated" separately, as opposed to "considered" separately when classifying them and this may have been where the confusion arose.

Many answers lacked consistency. For example, the land would be identified as being an operating lease but then the full lease payment was added back and used in the finance lease table. Land was identified as having an indefinite life but then the total, including land, was used for the depreciation working. The finance lease table itself was generally correctly done, although the opening figure was often incorrect and a minority of candidates treated the payments as made in arrears rather than in advance. The majority of candidates incorrectly identified that the depreciation on the building should have been over 40 years rather than 42 years, even where they had identified that ownership passed. Almost all candidates stated that the closing liability needed to be split into current and non-current but a significant number gave an incorrect split of the total figure.

Issue (2): Most candidates correctly identified that the decommissioning costs should have been added to the asset's carrying amount, but fewer identified that a provision should be set up to complete the double entry. Of those that did, only a minority set out the IAS 37 conditions for the recognition of a provision and fewer still applied these conditions to the scenario. The majority of candidates correctly identified that the amount should be discounted although a minority used the incorrect discount rate. It was pleasing to see that the majority of candidates also correctly depreciated the revised carrying amount of the asset and realised that they needed to do some unwinding of the provision (even where they hadn't identified that a provision should be recognised). The main concern with this issue was a lack of supporting narrative with many answers containing little more than a series of numbers.

Issue (3): The answers for the sale and repurchase were mixed with the majority of candidates concluding that this was a sale and leaseback rather than a sale and repurchase. However, a number of marks were still available for a good discussion centred around the principles of substance over form and the non-transference of risks and rewards.

Many calculated an accrued finance cost based on the repurchase price less the sale price, failing to recognise that the repurchase was in two years' time, not one.

Issue (4): The final issue concerned an adjusting event after the reporting period, with most candidates correctly concluding that a provision needed to be made. However, around half of the candidates simply seemed to miss that this should have been a discussion about events after the reporting date and new information concerning a condition that existed at that date, rather than a simple assessment of a provision. Therefore a number of easy marks were lost through lack of narrative.

Total possible marks	26½
Maximum full marks	18

(b) Revised earnings and basic EPS

	£
Earnings per draft financial statements	500,500
Add back: Operating lease rental (1)	120,000
Less: Finance cost re leased asset (1)	(117,084)
Depreciation on leased asset (1)	(28,173)
Depreciation on decommissioning costs (2)	(7,130)
Finance cost re decommissioning costs (2)	(2,495)
Profit on "sale" of land (3)	(250,000)
Finance cost re land "sold" (3)	(52,500)
Damages/costs in court case	(125,000)
Revised earnings figure	38,118

Weighted average number of ordinary shares:

	Number of shares		*Weighted average*
1 January 2013	100,000	x 6/12 x 5/4	62,500
Bonus issue (1 for 4)	25,000		
1 October 2013	125,000	x 3/12	31,250
Issue at full market price	80,000		93,750
31 December 2013	205,000	x 3/12	51,250
			145,000
EPS (38,118 ÷ 145,000)			26.3p

Per IAS 33, Earnings per Share, the calculation of basic earnings per share should be based on the weighted average number of ordinary shares outstanding during the period. So where there have been share issues during the period, as here, it is incorrect to use the opening (or indeed the closing) number of shares. Where shares have been issued at market price, those shares should only be included in the shares in issue for part of the period – ie the period in which the proceeds from that share issue have generated earnings. Conversely, because bonus shares have not generated any cash/earnings they are dealt with in the calculation by IAS 33 by assuming that the shares have always been in issue.

The majority of candidates made a good attempt at adjusting the "earnings" given in the question by their figures calculated in Part (a). It was common to see this as the first page of the answer to Question 2, showing that candidates had heeded advice from the examining team about building up this part of an answer as they went along. A few candidates, however, disadvantaged themselves by combining various figures from Part (a) into a "net" adjustment for each issue – all well and good if an audit trail was provided, but if not marks could well have been lost.

The calculation of the weighted average number of shares was, however, disappointing, compared to when an EPS calculation was set in a previous paper. A significant number of candidates were unable to correctly calculate this figure. The most common errors were to use the wrong number of months or to incorrectly adjust for the bonus issue.

The final element of this part of the question was to explain why the managing director was incorrect in basing his EPS calculation on the opening number of ordinary shares. It was disappointing that few candidates went beyond saying that this was wrong and that the managing director should have used a weighted average number of shares. Very few made any link between the issue of shares and the earnings those shares might or might not generate depending on whether the issue was for cash or not.

Total possible marks	8½
Maximum full marks	6

(c) Ethical issues

The MD has given plausible reasons for the accounting treatment of the issues identified. Each issue is technical in nature and the treatments may appear reasonable to a business manager with a general appreciation of accounting principles but not a detailed awareness of current reporting standards.

However, the MD appears to be applying pressure to have his treatments confirmed by offering incentives for compliance with his wishes (intimidation threat). I should not be swayed by the thought of being made the new FD (self-interest threat). Furthermore, all the treatments adopted by him have the effect of increasing the EPS figure to above that of the previous year, which is said to be a key criteria for the board. Once the correct treatments are adopted basic EPS in fact falls back to below the level of the previous year to 26.3p compared to 70.3p. Even if last year's EPS is restated for the bonus issue to 56.2p (70.3p x 4/5) this is still a fall in EPS – not the "significant improvement" that the board is looking for.

The finance director (FD) left under suspicious circumstances, which need to be confirmed. It may be that he too was put under pressure to adopt incorrect accounting treatments and found the situation untenable.

IFRS is quite clear on the appropriate treatment of these four issues. There is little, if any, choice or judgement on any of the matters. I should not give in to the MD's wishes or prepare financial statements that are contrary to IFRS.

I should apply the ICAEW Code of Ethics, with the following programme of actions:

- Explain matters to the MD with supporting evidence so that the matters can be corroborated.
- If resolution cannot be achieved, discuss the matters with the other directors to explain the situation and obtain support. Consider also discussing the issues with the external auditors/audit committee.
- Obtain advice from the ICAEW helpline or local members responsible for ethics.

During the resolution process it would be useful to keep a written record of all discussions, who else was involved and the decisions made.

Almost all candidates made a reasonable attempt at this part of the question, with a good number obtaining three or four marks, although five marks was rare. Candidates should remember that to gain the most marks their answer should be tailored to the question scenario. Most candidates correctly identified that the departure of the finance director was suspicious and that there was a self-interest threat and an intimidation threat for the financial controller. They then went on to explain how these threats arose and to suggest appropriate courses of action. A minority of candidates answered as if this was a problem facing an external auditor, not an accountant in a company. Others were concerned about the managing director's lack of technical competence and adherence to the Code of Ethics when he was not a qualified accountant. As ever, a few felt there were money laundering issues at play.

Total possible marks	8½
Maximum full marks	5

Question 3

Total Marks: 19

General comments

This question required the preparation of a consolidated statement of financial position. The group had two subsidiaries, one of which was acquired at the start of the year. The question featured contingent consideration, both goodwill and a gain on bargain purchase, fair value adjustments on acquisition, and inter-company trading between the two subsidiaries, with adjustments needed to reconcile the intra-group balances and deal with goods in transit.

Laois plc

Consolidated statement of financial position as at 31 December 2013

Assets	**£**	**£**
Non-current assets		
Property, plant and equipment (2,687,000 + 2,196,000 + 591,800 + (200,000 – 40,000 (W1))		5,634,800
Goodwill (W3)		168,000
		5,802,800
Current assets		
Inventories (193,200 + 53,700 + 159,000 – 5,000 (W7) + 12,000 (W7))	412,900	
Trade and other receivables (288,000 + 92,300 + 207,000 – 50,000 – 15,000 (W7))	522,300	
Cash and cash equivalents (15,800 + 12,400 + 1,100)	29,300	
		964,500
Total assets		6,767,300
Equity and liabilities		
Equity		
Ordinary share capital		2,000,000
Share premium account		750,000
Retained earnings (W6)		1,992,480
Attributable to the equity holders of Laois plc		4,742,480
Non-controlling interest (W5)		649,520
		5,392,000
Current liabilities		
Trade and other payables (398,600 + 220,800 + 436,400 – 50,000)	1,005,800	
Deferred consideration	104,000	
Taxation (150,000 + 105,000 + 10,500)	265,500	
		1,375,300
Total equity and liabilities		6,767,300

Workings

(1) Net assets – Carlow Ltd

	Year end	*Acquisition*	*Post acq*
	£	**£**	**£**
Share capital	650,000	650,000	
Share premium	300,000	300,000	
Retained earnings	1,078,600	592,000	
FV adj	200,000	200,000	
Deprec on FV adj (200,000/25 years x 5)	(40,000)	–	
PURP (5,000 + 3,000) (W7)	(8,000)	–	
	2,180,600	1,742,000	438,600

(2) Net assets – Kerry Ltd

	Year end	Acquisition	Post acq
	£	£	£
Share capital	360,000	360,000	
Retained earnings	176,000	240,000	
Goodwill adj	(24,000)	(30,000)	
	512,000	570,000	(58,000)

(3) Goodwill – Carlow Ltd

	£
Consideration transferred	1,560,000
Non-controlling interest at acquisition at fair value	350,000
Less: Net assets at acquisition (W1)	(1,742,000)
	168,000

(4) Gain on bargain purchase – Kerry Ltd

	£
Consideration transferred	
Cash	200,000
Deferred consideration at present value (104,000/1.04)	100,000
Non-controlling interest at acquisition at fair value	235,000
Less: Net assets at acquisition (W2)	(570,000)
	(35,000)

(5) Non-controlling interest

	£	£
Carlow Ltd		
Fair value at acquisition	350,000	
Share of post-acquisition reserves (438,600 (W1) x 20%)	87,720	
		437,720
Kerry Ltd		
Fair value at acquisition	235,000	
Share of post-acquisition reserves ((58,000) (W2) x 40%)	(23,200)	
		211,800
		649,520

(6) Retained earnings

	£
Laois plc	1,645,400
Less: Unwinding of discount (104,000 – 100,000	(4,000)
Carlow Ltd (80% x 438,600 (W1))	350,880
Kerry Ltd (60% x (58,000) (W2))	(34,800)
Gain on bargain purchase (W4)	35,000
	1,992,480

(7) PURP

	%	Sales in year £	Goods in transit £
SP	125	50,000	15,000
Cost	(100)	(40,000)	(12,000)
GP	25	10,000	3,000
x ½		5,000	

Generally candidates performed well on this question with a reasonable number achieving full marks. Nearly all candidates produced the expected standard workings (which are to be strongly encouraged) and a significant number arrived at the correct figures for the goodwill and gain on bargain purchase. Most then correctly took the gain to retained earnings although a minority netted it off against the goodwill figure. The fair value adjustment to property was well dealt with (although a number used the incorrect number of years when calculating the depreciation adjustment) as was the calculation of the unrealised profit on the goods held at the year end. Most candidates also correctly followed these adjustments through to property, plant and equipment and inventory respectively.

However, the adjustments for the goods in transit were not well dealt with and few candidates dealt correctly with all aspects of this (although many did at least calculate the adjustment for unrealised profit). A good number of candidates failed to increase inventories by the cost of the goods in transit between the two subsidiaries at the year end. Others failed to reduce trade and other receivables by the selling price of these goods, to reflect the fact that the receivable for the goods in transit had already been accounted for in the selling subsidiary's own financial statements.

The goodwill held within the subsidiary also caused problems and a considerable number of students completely ignored it in the net assets working, with a minority adding rather than deducting it. Many also did not understand the impact of the impairment that had been recognised within the subsidiary in relation to this goodwill and went on to make incorrect adjustments to the discount on acquisition calculated for this subsidiary and/or to retained earnings.

The aspect of the question that was least well dealt with was the deferred consideration. Although virtually all candidates used the correct figure to add to consideration very few then charged the unwinding of the discount to retained earnings. Even fewer showed anything in liabilities and even when they did it was often the wrong number.

Other common errors included the following:

- Making adjustments for unrealised profits in the wrong place (ie against the net assets of the subsidiary buying the inventory or in retained earnings or in both).
- Omitting the balance on the share premium account from the net assets table.
- Entering figures such as the fair value adjustment in one column of the net assets table rather than in both.
- Attempting to calculate the non-controlling interest by taking a percentage of closing net assets (which would work for the proportionate method) when this is clearly wrong if the fair value method is being used.
- Adjusting trade receivables for the cost of the inventory in transit rather than for the sales price.
- Adjusting trade payables for goods in transit when no liability had been recognised.
- Adding (rather than deducting) post-acquisition losses to the non-controlling interest and retained earnings workings.

It is disappointing that a good number of candidates still lose marks for failing to show an “audit trail”, particularly for the share of post- acquisition profit or loss to be taken to the non-controlling interest and retained earnings workings. To ensure they get the relevant marks candidates must show the figure (to check that the correct movement in the net assets working has been picked up) multiplied by the appropriate percentage. Many candidates actually waste time by writing out, for example, “NCI share of post- acquisition profit” when it would be faster and clearer to show, for example, “£58,000 x 20%”.

Total possible marks	20½
Maximum full marks	19

Question 4

Total Marks: 21

General comments

This question required the redrafting of extracts from the consolidated financial statements. Matters to be adjusted for were the disposal of a subsidiary, the setting up of a joint venture and a development project. Part (b) required an explanation of the differences between IFRS and UK GAAP in respect of these issues. Part (c) required a calculation of distributable profits and explanation thereof.

Kildare plc

(a) Extracts from the consolidated financial statements for the year ended 31 December 2013

	£
Consolidated statement of profit or loss (extracts)	
Profit attributable to	
Owners of Kildare plc (W5)	899,590
Non-controlling interest (256,700 + (37,500 (W5) x 30%))	267,950
Consolidated statement of financial position (extracts)	
Non-current assets	
Property, plant and equipment (2,752,100 + 90,000 – 15,000 (W4))	2,827,100
Intangibles (356,000 + 115,000 + 15,000* (W4))	486,000
Investment in joint venture (W2)	110,480
Consolidated statement of cash flows (extract)	
Net cash from investing activities (– 50,600 + (300,000 – 1,500)) – (115,000 + 90,000) (W4) + 10,000)	52,900

***Note:** Credit was also given if the depreciation on the equipment (W4) was expensed, rather than being recapitalised.

Workings

(1) Profit on disposal of subsidiary

	£	£
Sale proceeds		300,000
Less: Carrying amount of goodwill at date of disposal		
Consideration transferred	225,000	
NCI at acquisition (214,900 x 30%)	64,470	
Less: Net assets at acquisition (50,000 + 158,900 + (35,000 – 29,000))	(214,900)	
Goodwill at acquisition	74,570	
Less: Impairments to date	(40,000)	
		(34,570)
Less: Carrying amount of net assets at date of disposal (50,000 + (275,000 – (75,000 x 6/12)))		(287,500)
Add back: NCI at date of disposal (287,500 x 30%)		86,250
Profit on disposal		64,180

(2) Investment in joint venture

	£
Cost of investment	80,000
Share of post-acquisition increase in net assets ((48,400 + 52,800) x 40%)	40,480
Less: Dividend received	(10,000)
	110,480

(3) Share of profits of joint venture

	£
Share of JV's PAT (40% x 48,400)	19,360
Less: Share of PURP (40% x (120,000 x 25% x ½))	(6,000)
	13,360

(4) R&D expenditure

		£
Per Suspense account		275,000
Less: Carried forward as Intangibles:		
Qualifying development costs	110,000	
Patent registration costs	5,000	
		(115,000)
		160,000
Carried forward as PPE		(90,000)
Written off (initial research costs + evaluation of research findings) (β)		70,000
Depreciation on equipment (90,000/3 x 6/12)		15,000

(5) Profit attributable to owners

	£
Per draft	865,800
Profit on disposal of subsidiary (W1)	64,180
Share of profit of subsidiary (75,000 x 6/12 = 37,500 x 70%)	26,250
Share of profit of JV	13,360
Research costs etc (W4)	(70,000)
	899,590

Answers to this part were generally disappointing. Although it was the most challenging question on the paper there were many easy marks available for basic consolidation workings (such as the disposal of the subsidiary) and for adjustments to property, plant and equipment and intangible assets. Answers were generally difficult to follow often with lengthy and unnecessary workings.

Fewer candidates than normal managed to calculate the profit on disposal correctly although it was more common to see the correct figure for goodwill. Many candidates produced one combined and somewhat "muddled" working here which often resulted in the impairment to goodwill decreasing rather than increasing the profit on disposal. Furthermore, many candidates clearly did not understand that the whole of the profit on disposal should have been allocated to the owners, but that the profit of the subsidiary for the year up to disposal should have been split between the owners and the non-controlling interest.

It was extremely disappointing to see how few candidates realised that equipment used for research and development should be included within property, plant and equipment rather than in intangible assets. Candidates also struggled to decide how much of the research and development costs should be capitalised and how much should be expensed. These were very simple decisions that should have been quickly made and the appropriate adjustments taken directly to the extracts. Nearly all candidates calculated an amortisation charge for the capitalised development costs even though the new product was still in the development stage.

The joint venture also caused problems, in particular the calculation and treatment of the provision for unrealised profits. Those candidates who did attempt to calculate the latter often failed to multiply it by the relevant percentage.

Many candidates did adjust the cash used in investing activities for the proceeds of the disposal (net of the cash held by the subsidiary) and for the dividend received from the associate. However, some also used the former (net) figure when calculating the profit on disposal of the subsidiary. It was, however, rare to see the cash used in investing activities adjusted for the amounts spent on intangibles and property, plant and equipment.

Other specific errors not noted above included the following:

- Omitting to time apportion the current year depreciation charge.
- Omitting to time apportion the post-acquisition profits to be added to the non-controlling interest and owner's share of profits (and/or failing to multiply them by the relevant percentage).
- Assuming the shares had a nominal value of £1 rather than the 50p given in the question.
- Ignoring the fair value adjustment for inventory or including it in net assets at the year end (as well as or instead of at acquisition), even though it had been sold.
- Attempting to adjust the year end figure for intangibles by the cumulative impairment losses of £40,000 in respect of the disposed of subsidiary, despite the fact that it had been disposed of by this stage (and it was stated in any case in the question that no amounts in respect of this subsidiary had been consolidated).
- Treating the joint venture as if it had been bought on the first day of the current year rather than of the previous year.
- Taking the wrong figure for the cost of the joint venture (the most common error being to take the whole of the joint venture's share capital rather than the 40% which the parent company had purchased).
- Taking the total post-acquisition profits of the joint venture to investment in joint venture rather than the appropriate percentage (and/or only taking one year's profits).
- Not showing the investment in the joint venture within the non-current assets section of the extracts.

Total possible marks Maximum full marks	16½ 12

(b) IFRS v UK GAAP differences

Under IAS 38, Intangibles, development expenditure *must be* capitalised where the relevant criteria are met. Under UK GAAP (SSAP 13) the capitalisation of development expenditure which meets certain criteria is optional.

The development expenditure recognition criteria of SSAP 13 include a requirement to have or a reasonable expectation of future benefits. IAS 38 is more stringent as the requirement is to demonstrate future benefits.

UK GAAP (FRS 10) would have required the goodwill arising in the business combination with Sligo Ltd to be amortised over its finite useful life. Under IAS 38 goodwill is tested annually for impairment.

Under UK GAAP (FRS 6) minority interest (the non-controlling interest) is always measured at its share of net assets. IFRS 3 allows non-controlling interest to be measured at fair value (the fair value method) or at its share of net assets (the proportionate method as used here).

UK GAAP (FRS 9) requires the use of the gross equity method for joint ventures. IAS 28, Investments in Associates and Joint Ventures, requires the use of the equity method.

The gross equity method is the same as the equity method except that disclosure is required of the following figure:

- in the profit and loss account – the investor's share of the turnover of its joint venture
- in the balance sheet – the investor's share of the gross assets and liabilities underlying the net equity amount.

Answers to this part were mixed but most candidates did manage to pick up at least a couple of marks although very few gained full marks. As in previous sittings the main problem is that candidates include differences that are not relevant to the actual issues given, such as discussing the treatment of "negative" goodwill when there was no negative goodwill in this scenario.

Total possible marks Maximum full marks	6 4

(c) Distributable profits and explanation	
For entities within a group, the calculation of distributable profits must be made for each entity separately, not for the consolidated group. Therefore Kildare plc's distributable profits are those distributable by the parent company only. The basic rule is that distributable profits are measured as accumulated realised profits less accumulated realised losses. In the case of listed companies, the amount of distributable profits is further reduced by any excess of unrealised losses over unrealised profits. In the case of Kildare plc, insufficient information is available in the scenario to identify any such excess. Assuming that no such excess exist, then distributable profits are calculated as below: • The disposal of the shares in Sligo Ltd affect Kildare plc's parent company figures by the (as yet unrecorded) parent company profit. This profit is the difference between the cost of the shares (£225,000) and the sale proceeds (£300,000), increasing Kildare plc's single entity retained earnings by £75,000. • The share of profits in the joint venture only affects the consolidated retained earnings, but Kildare plc's own financial statements would include the dividend from Mayo Ltd of £10,000. Since this has been credited to a suspense account, Kildare plc's single entity retained earnings need increasing by £10,000. • The research and development costs were spent by Kildare plc and therefore any adjustments in respect of this affect its individual financial statements and hence distributable profits. Kildare plc's single entity retained earnings need reducing by £70,000 (W4). As there is no further information on the reserve balances which form part of equity, the distributable profits of Kildare plc are therefore: 109,700 + 75,000 + 10,000 – 70,000 = £124,700 **Note:** Credit was also given, where the depreciation on the equipment in Part (a) had been expensed, for discussing the impact of this on distributable profits.	
It was clear that very few candidates had spent any time on understanding distributable profits. A significant number of candidates did not attempt this part of the question and even when they did make some attempt, often achieved no marks at all. Very few candidates knew even the most basic points (such as realised profits less realised losses) or that distributable profits are based on the individual company's financial statements. Many candidates who did attempt this part of the question wasted time by simply copying out adjustments made in Part (a) of the question that related to the consolidated financial statements	
Total possible marks	7
Maximum full marks	5

PROFESSIONAL LEVEL EXAMINATION

MONDAY 8 JUNE 2015

(3 hours)

FINANCIAL ACCOUNTING AND REPORTING

This paper consists of **FOUR** questions (100 marks).

1. Ensure your candidate details are on the front of your answer booklet. You will be given time to sign, date and print your name on the answer booklet, and to enter your candidate number on this question paper. You may not write anything else until the exam starts.

2. Answer each question in black ball point pen only.

3. Answers to each question must begin on a new page and must be clearly numbered. Use both sides of the paper in your answer booklet.

4. The examiner will take account of the way in which answers are presented.

5. When the assessment is declared closed, you must stop writing immediately. If you continue to write (even completing your candidate details on a continuation booklet), it will be classed as misconduct.

Unless otherwise stated, make all calculations to the nearest month and the nearest £.

All references to IFRS are to International Financial Reporting Standards and International Accounting Standards.

IMPORTANT Question papers contain confidential information and must NOT be removed from the examination hall. **DO NOT TURN OVER UNTIL YOU ARE INSTRUCTED TO BEGIN WORK**	You MUST enter your candidate number in this box. |				

1. The following trial balance has been extracted from the nominal ledger of Antigua plc at 31 December 2014.

	Note(s)	£	£
Sales			8,417,010
Purchases		4,741,400	
Land and buildings	(1)		
Valuation (land £140,000)		1,490,000	
Accumulated depreciation at 31 December 2013			90,000
Plant and equipment	(1), (2)		
Cost		578,000	
Accumulated depreciation at 31 December 2013			231,200
Retained earnings at 31 December 2013		15,010	
Revaluation surplus at 31 December 2013			757,000
Ordinary share capital (£1 shares)			50,000
Bank account			101,300
Operating expenses	(3)	2,017,500	
Trade and other receivables		578,700	
Trade and other payables			325,100
Income tax	(4)		127,000
Inventories at 31 December 2013		678,000	
		10,098,610	10,098,610

The following additional information is available:

(1) Antigua plc originally measured its land and buildings under the cost model. All buildings were acquired on 1 January 2006 and had a zero residual value and a total estimated useful life of 50 years at that date. On 1 January 2011 Antigua plc adopted the revaluation model for its land and buildings and revalued all its land and buildings at that date, with no change to total estimated useful lives. No further revaluations have been necessary since this date.

On 31 December 2014 a building which was surplus to requirements met the "held for sale" criteria of IFRS 5, Non-current Assets Held for Sale and Discontinued Operations. The building is included in property, plant and equipment at its carrying amount on 31 December 2013. Details in respect of this building are as follows:

	£
Cost on 1 January 2006	76,000
Valuation on 1 January 2011	108,000
Estimated fair value on 31 December 2014	58,000
Estimated costs to sell	5,000

Depreciation for the year ended 31 December 2014 has not yet been charged on any of Antigua plc's property, plant and equipment. Depreciation on buildings should be presented in operating expenses and depreciation on plant and equipment should be presented in cost of sales. Plant and equipment is depreciated on a reducing balance basis using a rate of 20% pa.

Antigua plc does not make annual transfers between the revaluation surplus and retained earnings.

(2) On 1 July 2014 Antigua plc paid £103,500 for a piece of high-tech equipment, which is included in the total for plant and equipment in the trial balance above. A government grant of 50% of the cost of the equipment was received to help finance the purchase of this equipment as part of the government's drive to encourage investment in new technology. There were no future performance-related conditions attached to the grant. The grant was debited to cash and credited to purchases, although Antigua plc's published accounting policy for government grants is to use the netting-off method.

(3) On 1 January 2014 Antigua plc entered into a six year finance lease for a machine with a fair value of £50,250, a zero residual value and a useful life of seven years. Lease payments of £9,250 are due annually on 1 January. The first payment of £9,250 was duly made on 1 January 2014 and included in operating expenses. No other accounting entries have been made in respect of this lease. Antigua plc allocates finance charges on a sum-of-the-digits basis.

(4) The income tax in the trial balance represents a refund in respect of prior years, which was made on 15 June 2014, following an appeal to HMRC. The income tax liability for the year ended 31 December 2014 has been estimated at £497,500.

(5) Inventories at 31 December 2014 were valued at their cost of £752,000. This included £118,000 for one product line which had a total list price of £142,000 on 31 December 2014. However, on 15 January 2015 the directors discovered that, since December 2014, a number of competitors had been selling an equivalent product for 30% less than Antigua plc's list price.

Requirements

(a) Prepare a statement of profit or loss for Antigua plc for the year ended 31 December 2014 and a statement of financial position as at that date, in a form suitable for publication.

(25 marks)

NOTES: Notes to the financial statements are not required.
Expenses should be analysed by function.

(b) Describe the differences between IFRS and UK GAAP in respect of the financial reporting treatment of the government grant. **(3 marks)**

(c) The IASB Conceptual Framework refers to five elements of the financial statements. Give one example of each of these elements from the financial statements of Antigua plc, explaining how each meets the definition of the relevant element. **(5 marks)**

Total: 33 marks

2. The finance director of the Cuba Ltd group, Philippe, who is due to retire very shortly, has prepared draft consolidated financial statements for the year ended 31 December 2014. Shortly after Philippe completed the draft consolidated financial statements, he was taken ill and has been on sick leave since then. The managing director of Cuba Ltd asked José, the financial controller, to make any adjustments necessary to complete the consolidated financial statements. Both José and Philippe are ICAEW Chartered Accountants.

On examining the draft financial statements prepared by Philippe, José has identified the following issues:

(1) On 1 January 2014 Cuba Ltd acquired a zero coupon bond with a nominal value of £100,000 for £94,500. The bond is quoted in an active market. Broker's fees of £2,500 were incurred in relation to the purchase and recognised in profit or loss. The bond is redeemable on 31 December 2015 at a premium of 10% of its nominal value and will be held to maturity. The effective interest rate on the bond is 6.49%. On purchase of the bond Philippe debited investments within non-current assets with £110,000, being the redemption value, credited cash with £94,500 and credited income with £15,500, and has made no subsequent accounting entries in respect of this bond.

(2) On 1 July 2014 Cuba Ltd disposed of its entire holding in Honduras Ltd for £256,600. Cuba Ltd had acquired 80% of the ordinary share capital of Honduras Ltd a number of years ago for £147,800, when the fair value of Honduras Ltd's net assets was £157,500. At acquisition, the non-controlling interest was measured at its fair value of £40,100. No impairment losses in respect of goodwill acquired in the business combination with Honduras Ltd have arisen.

At 31 December 2013, Honduras Ltd had net assets with a fair value of £301,000. In the year ended 31 December 2014 Honduras Ltd made a loss of £16,600, with revenue and costs accruing evenly over the year.

In the draft consolidated financial statements for the year ended 31 December 2014 Philippe has included a single figure for Honduras Ltd: a profit on disposal of £108,800, being the difference between the sale proceeds of £256,600 and the cost of the original investment of £147,800. The investment in Honduras Ltd represented a separate major line of business of the Cuba Ltd group.

(3) In previous years Cuba Ltd had traded only with UK suppliers. However, in November 2014, Cuba Ltd began importing goods from Germany. The goods were received on 23 November 2014, and the purchase invoice, for €158,000, was correctly processed by Philippe. No adjustments have subsequently been made to this figure.

At the year end the invoice was unpaid and the goods were still in inventory. Philippe has valued this inventory using the spot rate at 31 December 2014 and included it in closing inventory used to prepare the draft consolidated financial statements.

The spot exchange rates were as follows:

23 November 2014 – €1:£0.85
31 December 2014 – €1:£0.90

(4) During the year Cuba Ltd made a significant proportion of its purchases (£550,000) from Grenada Ltd, a company owned by Philippe's wife. At 31 December 2014 £75,000 was due to Grenada Ltd in respect of these purchases. No disclosure of this transaction has been made in Cuba Ltd's draft consolidated financial statements. When José queried this with the managing director of Cuba Ltd, the managing director told him that he had been assured by Philippe that no disclosure was necessary as the purchases had all been made at an arm's length price.

Philippe is due to return to work next week and has told José, in a brief telephone call, that he is expecting to present the draft consolidated financial statements to the board exactly as he prepared them as he has already accrued for his bonus based on the consolidated profit for the year per those draft financial statements.

Requirements

(a) Explain the required IFRS financial reporting treatment of the four issues above in the consolidated financial statements of Cuba Ltd for the year ended 31 December 2014. You should prepare all relevant calculations and quantify the effects on the draft financial statements where possible. **(21 marks)**

(b) Discuss the ethical issues arising for Philippe and José from the scenario and the steps that José should take to address them. **(5 marks)**

(c) Describe the differences between IFRS and UK GAAP in respect of the financial reporting treatment of Issue (2) above. **(2 marks)**

Total: 28 marks

3. Columbia plc operates in the manufacturing sector. The company's statement of financial position as at 31 December 2013 included the following balances:

	£
Property, plant and equipment	1,456,700
Ordinary share capital (£1 shares)	300,000
Share premium account	35,000
Retained earnings	145,800
	480,800

The following information is relevant to its financial statements for the year ended 31 December 2014:

(1) Columbia plc constructed a new manufacturing facility, capitalising the following costs, all of which were incurred between 1 January 2014 and 30 November 2014:

	£
Site preparation	100,000
Materials and labour	358,300
Professional fees	10,000
General overheads	32,500
Construction overheads	11,000
Costs of relocating staff to the new facility	45,600
Initial safety inspection	21,000

The facility was ready for use on 30 November 2014. However, due to delays in moving equipment into the facility, it was not in fact used until January 2015. As a result no depreciation on the facility has been calculated or recognised. The overall life of the facility is estimated to be 20 years. The next safety inspection is due in three years' time and thereafter every three years.

(2) The following transactions took place and were recognised in respect of other property, plant and equipment:

- Depreciation of £235,600 was charged.
- An asset with a carrying amount of £125,700 was disposed of at a loss of £14,300.
- Columbia plc acquired plant and equipment for cash of £432,500.

(3) The following share issues were made during the year ended 31 December 2014. All shares have a nominal value of £1 per share.

Date	Type of shares	Number of shares	Issue price
1 February 2014	Ordinary	75,000	£1.50 per share
1 July 2014	4% Irredeemable preference	50,000	Par
1 November 2014	Ordinary	1 for 4 bonus issue	-

The dividend on the irredeemable preference shares is mandatory and if it is unpaid at the end of the period it becomes cumulative in the following period. The dividend due on these shares was paid on 1 January 2015 but no entry was made in the financial statements for the year ended 31 December 2014. An interim ordinary dividend of 15p per share was paid on 30 June 2014.

(4) Columbia plc's draft statement of profit or loss for the year ended 31 December 2014 shows a profit for the year of £52,600. Columbia plc wishes to retain the maximum balance on retained earnings whilst still following IFRS.

Requirements

(a) Explain the required IFRS financial reporting treatment of the manufacturing facility described in (1) above, with supporting calculations. **(5 marks)**

(b) (i) Calculate a revised profit for Columbia plc for the year ended 31 December 2014.

(ii) Prepare extracts from Columbia plc's statement of financial position as at 31 December 2014, and the investing and financing sections of its statement of cash flows for the year then ended. **(14 marks)**

Total: 19 marks

4. Dominica plc has investments in two companies, a subsidiary, Tobago Ltd, and an associate, Anguilla Ltd. The unqualified assistant accountant has prepared a draft consolidated statement of financial position at 31 December 2014 by simply adding together each line of the individual statements of financial position of Dominica plc and Tobago Ltd. However, he was unsure how to deal with Anguilla Ltd so has not included any of that company's figures in the consolidation.

The draft consolidated statement of financial position as at 31 December 2014 is shown below, together with the individual statement of financial position of Anguilla Ltd at the same date:

	Dominica plc group (draft consolidated) £	Anguilla Ltd £
ASSETS		
Non-current assets		
Property, plant and equipment	3,780,400	351,200
Investments	756,000	–
	4,536,400	351,200
Current assets		
Inventories	400,800	42,000
Trade and other receivables	182,400	35,600
Cash and cash equivalents	53,400	6,800
	636,600	84,400
Total assets	5,173,000	435,600
EQUITY AND LIABILITIES		
Equity		
Ordinary share capital (£1 shares)	1,400,000	200,000
Share premium account	890,000	–
Revaluation surplus	1,061,600	–
Retained earnings	1,367,900	168,100
	4,719,500	368,100
Current liabilities		
Trade and other payables	320,000	61,900
Taxation	133,500	5,600
	453,500	67,500
Total equity and liabilities	5,173,000	435,600

Additional information:

(1) Dominica plc acquired 85% of Tobago Ltd on 1 January 2014 for £600,000 when Tobago Ltd's equity was as follows:

	£
Ordinary share capital (£1 shares)	160,000
Share premium account	80,000
Revaluation surplus	140,000
Retained earnings	63,200
Equity	443,200

On 31 December 2014 Tobago Ltd's retained earnings were £181,500 and its revaluation surplus was £240,000. All other components of equity were unchanged.

The consideration of £600,000 was made up of £400,000 cash payable immediately and a further £200,000 payable on 31 December 2015 if the post-acquisition profits of Tobago Ltd exceeded a certain amount by that date. At 1 January 2014 the probability of Tobago Ltd hitting the earnings target was such that the fair value of the possible cash payment was £100,000. At 31 December 2014 the probability had risen such that the fair value of the possible cash payment was judged to be £150,000. When preparing the draft consolidated statement of financial position the assistant accountant included the full £600,000 in investments and the full £200,000 in trade and other payables.

The fair values of the assets and liabilities of Tobago Ltd at the date of acquisition were equal to their carrying amounts, with the exception of inventory. On 1 January 2014 the fair value of Tobago Ltd's inventories was £124,000 but their carrying amount was £107,000. At 31 December 2014 half of these inventories were still held by Tobago Ltd.

Dominica plc has decided to measure goodwill and the non-controlling interest using the proportionate method.

(2) Dominica plc acquired 35% of Anguilla Ltd on 1 January 2005 for £156,000 when the retained earnings of Anguilla Ltd were £104,500. At this date a property owned by Anguilla Ltd had a fair value £100,000 in excess of its carrying amount and a remaining useful life of 20 years. The remaining assets and liabilities at the date of acquisition were equal to their carrying amounts.

(3) On 1 January 2014 Dominica plc sold a machine to Tobago Ltd for £180,000. The machine had a carrying amount in Dominica plc's books of £156,000. The estimated remaining useful life of the machine was reassessed on the date of sale at six years.

(4) During the year Dominica plc sold goods to Anguilla Ltd for £20,000, making a gross profit margin of 30%. At 31 December 2014 Anguilla Ltd held one-third of these goods in its inventories.

(5) Inventories in the statements of financial position of all three companies at 31 December 2014 were based on physical inventory counts carried out on 31 December 2014. However, on 10 January 2015 Tobago Ltd received a report from one of its customers, Trinidad Ltd, showing that on 31 December 2014 Trinidad Ltd held £23,600 (cost to Trinidad Ltd) of Tobago Ltd's inventories on a sale or return basis. Tobago Ltd makes a gross profit margin of 25% on all sales but has not yet raised any invoices for this transaction.

Requirement

Prepare the consolidated statement of financial position of Dominica plc as at 31 December 2014.

Total: 20 marks

MARK PLAN AND EXAMINER'S COMMENTARY

The marking plan set out below was that used to mark this question. Markers were encouraged to use discretion and to award partial marks where a point was either not explained fully or made by implication. More marks were available than could be awarded for each requirement. This allowed credit to be given for a variety of valid points which were made by candidates.

Question 1

Total Marks: 33

General comments

Part (a) of this question tested the preparation of a statement of profit or loss and a statement of financial position from a trial balance plus a number of adjustments. Adjustments included an asset held for sale which had previously been revalued, a finance lease, the receipt of a government grant, an adjusting event after the reporting period and an income tax refund. Part (b) tested the difference between the IFRS treatment of the government grant and that under UK GAAP. Part (c) tested the definitions of the elements of financial statements with application to the financial statements prepared in Part (a).

Antigua plc

(a) Financial statements

Statement of profit or loss for the year ended 31 December 2014

	£
Revenue	8,417,010
Cost of sales (W1)	(4,799,960)
Gross profit	3,617,050
Operating expenses (W1)	(2,044,050)
Profit from operations	1,573,000
Finance cost (W7)	(1,750)
Profit before tax	1,571,250
Income tax expense (497,500 – 127,000)	(370,500)
Profit for the year	1,200,750

Statement of financial position as at 31 December 2014

	£	£
Assets		
Non-current assets		
Property, plant and equipment (1,271,600 + 283,090) (W2)		1,554,690
Current assets		
Inventories (W6)	733,400	
Trade and other receivables	578,700	
	1,312,100	
Non-current asset held for sale (58,000 – 5,000)	53,000	
		1,365,100
Total assets		2,919,790

Equity and liabilities	**£**	**£**
Equity		
Ordinary share capital		50,000
Revaluation surplus (W5)		717,400
Retained earnings (W4)		1,185,740
		1,953,140
Non-current liabilities		
Finance lease liabilities (W7)		33,500
Current liabilities		
Finance lease liabilities (W7)	9,250	
Trade and other payables	325,100	
Borrowings	101,300	
Taxation	497,500	
		933,150
Total equity and liabilities		2,919,790

Workings

(1) Allocation of expenses

	Cost of sales £	**Operating expenses £**
Per TB	4,741,400	2,017,500
Opening inventories	678,000	
Closing inventories (W6)	(733,400)	
Costs to sell held for sale asset		5,000
Loss on held for sale asset (W3)		800
Depreciation charge on buildings		30,000
Depreciation charges on plant and equipment (5,175 + 8,375 + 48,660 (W2))	62,210	
Add back government grant (103,500 x 50%)	51,750	
Lease payment wrongly included		(9,250)
	4,799,960	2,044,050

(2) PPE

	Land and buildings £	**Plant and equipment £**
B/f Valuation/Cost	1,490,000	578,000
B/f Accumulated depreciation	(90,000)	(231,200)
	1,400,000	346,800
Less: Held for sale asset (W3)	(98,400)	
Depreciation on buildings ((1,490,000 – 140,000) ÷ 45)	(30,000)	
Less government grant (W1)		(51,750)
Depreciation on equipment subject to grant (51,750 x 20% x 6/12)		(5,175)
Leased asset		50,250
Depreciation on leased asset (50,250 ÷ 6)		(8,375)
Depreciation on other plant and equipment ((346,800 – 103,500) x 20%)		(48,660)
	1,271,600	283,090

(3) Asset held for sale

	Asset	Revaluation surplus
	£	£
Cost on 1 January 2006	76,000	
Depreciation to 31 December 2010 (76,000/50 x 5)	(7,600)	
Carrying amount at 31 December 2010	68,400	
Revaluation on 1 January 2011	108,000	39,600
Depreciation to 31 December 2014 (108,000/45 x 4)	(9,600)	
Carrying amount at 31 December 2014	98,400	
Fair value	(58,000)	
	40,400	39,600
Charge to profit/revaluation surplus	800	(39,600)

(4) Retained earnings

	£
At 31 December 2013	(15,010)
Profit for the year	1,200,750
At 31 December 2014	1,185,740

(5) Revaluation surplus

	£
At 31 December 2013	757,000
Loss on held for sale asset (W3)	(39,600)
At 31 December 2014	717,400

(6) Closing inventories

	£
At cost	752,000
Less Write down to NRV ((142,000 x 70%) – 118,000)	(18,600)
	733,400

(7) Finance lease

	B/f	Payment	Capital	Interest	C/f
	£	£	£	£	£
31 December 2014	50,250	(9,250)	41,000	(5/15 x 5,250) 1,750	42,750
31 December 2015	42,750	(9,250)	33,500		

SOTD = (5 x 6)/2 = 15
Interest = (9,250 x 6) – 50,250 = 5,250

Generally candidates made a good attempt at this part of the question. However, presentation of the financial statements was often poor, and many scripts were messy and disorganised. It was noticeable that far less well-presented scripts than usual were seen. In particular it was often not possible to agree the figure taken to the statement of financial position for the carrying amount of property, plant and equipment to a single figure in the workings. Candidates should be aware that if such a figure cannot be seen in the workings then they will not gain the mark available for this figure on the face of the statement of financial position. In general, property, plant and equipment workings were often untidy and indicated that the approach to working out this figure was not methodical. The recommended approach is for candidates to use a property, plant and equipment "table" with supporting workings as needed.

Generally, candidates arrived at the correct figures for closing inventories, the income tax charge in the statement of profit and loss and the figure for non-current assets held for sale on the statement of financial position (with many candidates gaining the additional marks available for putting this in the correct place at the bottom of current assets). Many candidates made a good attempt at the workings in relation to the impairment on the asset held for sale, the most common errors being:

- a failure to revalue the asset to fair value first and therefore deal with the costs to sell separately
- errors in depreciation calculations (usually charging depreciation for an incorrect number of years)
- charging the whole of the impairment to the revaluation surplus, without first checking what the balance on the revaluation surplus in relation to the asset was
- charging the impairment to the revaluation surplus and the same figure as an expense in the statement of profit and loss
- having arrived at a figure for the carrying amount of the asset held for sale, failing to deduct this figure from property, plant and equipment, or deducting the fair value instead.

Surprisingly, the aspect of the question that caused the most problems was the finance lease. Usually, the majority of candidates would get the figures in relation to this completely correct, but, on this occasion, that was rare. Almost all candidates calculated a "sum of the digits" but this was often based on payments in arrears, rather than in advance, even where the candidate's lease "table" clearly showed payments in advance. Furthermore, a worrying number of candidates were unable to calculate the correct figure for total finance costs. Having calculated their own sum of the digits, some candidates then went on to use this as an interest rate in their leasing table. Finally, only a small number of candidates were able to correctly split the year-end liability, per their own table, into current and non-current, with few appreciating that for a lease where payments are in advance, the current liability will always be the payment for the next year.

Most candidates did use the recommended "costs matrix" when allocating costs for the statement of profit or loss, and entered the adjustments into the correct columns. Occasionally errors were made in terms of whether the adjustment was increasing or decreasing costs particularly with regard to the grant incorrectly credited to purchases. Candidates whose convention was to use figures in brackets for costs were generally the ones who got themselves into a muddle with the direction of their adjustments, as if they had reverted to the opposite convention part way through. A number of candidates failed to include all of their depreciation charges (on the leased asset, the asset subject to a grant, on the remaining plant and equipment, and on the building) in this matrix, even when they had calculated all of these elements in their property, plant and equipment workings. Once again, this indicated a disorganised approach.

Other common errors included the following:

- Showing the bank account (which was a credit balance in the trial balance) as a current asset, rather than as an overdraft in current liabilities.
- Adding the retained earnings brought forward (which was a debit balance in the trial balance) to their profit for the year, instead of deducting it.
- Reducing the income tax liability by the income tax refund when that refund had already been received (or showing the refund as a separate tax asset).
- Adding the grant to property, plant and equipment rather than deducting it.
- Charging a full year's depreciation on the asset subject to the grant, instead of six months.
- Using a useful life of seven years for the leased asset instead of the (shorter) lease term of six years.

Total possible marks Maximum full marks	27 25

(b) Differences between IFRS and UK GAAP re government grant

UK GAAP	IFRS
Grants are recognised under the performance model or the accrual model. This policy choice is to be made on a class-by-class basis.	No such requirement exists in IAS 20.
Under the performance model, where no specific performance-related conditions are imposed on the recipient (as here) then the grant is recognised in income when the grant proceeds are received or receivable. Hence, if the performance model had been chosen, then Antigua Ltd would have credited the whole £51,750 to income during the year.	This would not be possible under IFRS, where, under the chosen netting-off method, the grant is credited against the cost of the asset and so effectively released to profit or loss over the life of that asset, in line with the depreciation policy on that asset.
Under the accrual model grants relating to assets are recognised in income on a systematic basis over the expected useful life of the asset. However, this cannot be done by deducting the grant from the carrying amount of the asset, but by recognising deferred income.	

Most candidates made a reasonable attempt at this part of the question, with almost all stating that IFRS allows a choice of treatment, but that UK GAAP only allows the deferred income method. Most went on to clearly describe the mechanics of the two methods, although some wasted time providing calculations for the deferred income method, which were not required. Very few candidates gained full marks, and almost all candidates seemed unaware of the two models (performance and accrual) allowed by UK GAAP.

Total possible marks	6
Maximum full marks	3

(c) Elements of the financial statements

Asset – The finance lease is recognised as an asset because the machine is controlled by Antigua plc (has the risks and rewards), the control came about via the signing of the lease, which happened during the year, and the machine will be used in the business to generate future revenue.

Liability – The overdraft is recognised as a liability because it existed at the year end and will lead to future outflows in the form of repayment and interest payments.

Income – Revenue is a form of income as it brings cash inflows or enhancement of assets in the form of trade receivables.

Expenses – Depreciation is an expense as it reduces the carrying amount of property, plant and equipment (ie depletes an asset).

Equity – this equals Antigua plc's ordinary share capital, retained earnings and revaluation surplus as the sum of these is equal to total assets minus total liabilities/is the residual interest in the assets of the entity after deducting all its liabilities.

There were some very good attempts at this part of the question, with all five elements clearly stated, an appropriate example given for each, and a clear explanation of why the given example met the definition. At the other end of the scale were answers which, although they gave the five elements and appropriate examples, merely copied out the definitions of the elements from the open book text, without any attempt to relate those definitions to their examples, and therefore scored very little for their explanations. A significant minority of candidates confused "elements" with the fundamental and enhancing qualitative characteristics, thereby scoring no marks.

Total possible marks	8½
Maximum full marks	5

Question 2

Total Marks: 28

General comments

Part (a) of this question required candidates to explain the IFRS financial reporting treatment of the four issues given in the scenario. The issues covered a financial asset, the disposal of a subsidiary, a foreign exchange transaction and a related party transaction. Part (b) required a discussion of the ethical issues arising from the scenario and the action to be taken. Part (c) required candidates to describe any differences between IFRS and UK GAAP in respect of the financial reporting treatment of Issue (2).

Cuba Ltd

(a) IFRS financial reporting treatment

(1) Financial asset

The bond is a financial asset as defined by IAS 32, Financial Instruments: Presentation, because it represents a contractual right to receive cash from another entity.

Per IAS 39, Financial Instruments: Recognition and Measurement, financial assets should be recognised when the contract is entered into and initially measured at its fair value, including transaction costs. Fair value is defined by IFRS 13, Fair Value Measurement, but is normally the transaction price.

Hence Philippe was correct to recognise the asset on 1 January 2014, but should have recognised it at £97,000 (94,500 + 2,500), not £110,000. As this is a held-to-maturity financial asset, the asset should subsequently be measured at amortised cost using the effective interest method.

At 31 December 2014 interest of £6,295 (97,000 x 6.49%) should be recognised as income in profit or loss so the income recognised of £15,500 will need to be reduced by £9,205 (15,500 – 6,295). The bond should be stated at £103,295 (97,000 + 6,295). Because the bond is redeemable on 31 December 2015, ie within one year, it should be presented in investments within current assets.

(2) Disposal of subsidiary

In Cuba Ltd's consolidated financial statements the profit on disposal of Honduras Ltd should be calculated by comparing the net assets at the date of disposal and non-controlling interest (NCI), less goodwill on consolidation not already written off, to the sale proceeds. The net assets at the date of disposal will be the net assets brought forwards on 1 January 2014, less the loss earned by Honduras Ltd to the date of disposal/(six months pro-rated).

		£	£
Sale proceeds			256,600
Less:	Carrying amount of goodwill at date of disposal:		
	Consideration transferred at date of acquisition	147,800	
	Fair value of NCI at date of acquisition	40,100	
		187,900	
	Net assets as date of acquisition	(157,500)	
	Goodwill at date of acquisition and disposal		(30,400)
	Carrying amount of goodwill at date of disposal:		
	Net assets on 31 December 2013	301,000	
	Loss for current year to date of disposal (16,600 ÷ 2)	(8,300)	
	Carrying amount of net assets at date of disposal		(292,700)
Add:	NCI in net assets at date of disposal (40,100 + (292,700 – 157,500) x 20%))		67,140
Profit on disposal			640

This figure should be recognised in the consolidated statement of profit or loss as discontinued operations. In the consolidated statement of profit or loss, Cuba Ltd should include the results of Honduras Ltd up to the date of disposal. At the year end of 31 December 2014 the Cuba Ltd group no longer controls any of the assets or liabilities of Honduras Ltd and so the consolidated statement of financial position should not recognise any of Honduras Ltd's assets or liabilities.

The non-controlling interest figure will similarly include their share (20%) of six-twelfths of Honduras Ltd's loss for the year, being £1,660 (16,600 x 20% x 6/12). In the statement of changes of equity for the year the £67,140 above will be shown as a deduction in the non-controlling interest column.

Because the investment in Honduras Ltd represented a separate major line of business of the Cuba Ltd group, in the consolidated statement of profit or loss, the results of Honduras Ltd for the year ended 31 December 2014 should be presented separately in accordance with IFRS 5, Non-current Assets Held for Sale and Discontinued Operations. A single net figure of a loss of £7,660 for the discontinued operation should be disclosed on the face of the consolidated statement of profit or loss, being the profit on disposal of £640, less the loss for the period to disposal of £8,300. A disclosure note should show the breakdown of this figure into revenue, costs and the profit on disposal. Honduras Ltd's prior period results should be reclassified as discontinued in order to ensure comparability.

(3) Foreign exchange transaction

IAS 21, The Effects of Changes in Foreign Exchange rates, states that a foreign currency transaction should be recorded, on initial recognition in the functional currency, by applying the exchange rate between the reporting currency and the foreign currency at the date of the transaction/historic rate. When the goods were received on 23 November 2014, Philippe was correct to record them in purchases and trade payables at the spot rate of €1:£0.85, ie at an amount of £134,300 (158,000 x 0.85).

However, at the year end, IAS 21 requires that any foreign currency monetary items are retranslated using the closing rate. Monetary items are defined as "units of currency held and assets and liabilities to be received or paid in fixed or determinable number of units of currency". The trade payable in respect of this purchase meets the definition of a monetary item and should have been retranslated at the closing rate. This would have given a trade payable of £142,200 (158,000 x 0.90). This exchange loss of £7,900 (142,200 – 134,300) should have been included in the consolidated statement of profit or loss for the year ended 31 December 2014.

Furthermore, because inventory does not meet the definition of a monetary item, it should have been left as originally recorded, and not been restated. Closing inventory therefore should be reduced by the same amount (£7,900), further reducing the profit for the year.

(4) Related party transaction

This appears to be a related party transaction per IAS 24, Related Party Disclosures. Grenada Ltd is a related party of Cuba Ltd because Grenada Ltd is owned by a close family member of Cuba Ltd's key management personnel (ie it is owned by the wife of Cuba Ltd's finance director).

The following disclosures are therefore required, even if the purchases were indeed made on an arm's length basis:

- The nature of the related party relationship (ie that purchases have been made from a company owned by the finance director's wife).
- The amount of the transactions (£550,000).
- The amount of any balances outstanding at the year-end (£75,000).

Disclosure may be made of the fact that the transactions were made on an arm's length basis if this can be substantiated.

This question was not answered as well as the numeric parts of the paper, and indeed the other written parts. Candidates need to be aware that they can only score well on this type of question if they make a reasonable attempt to provide explanations, in addition to calculations.

Issue (1): This was generally very poorly answered with many candidates assuming this was a liability. Given that the bond was "purchased" as opposed to being "issued" it was clearly a financial asset, not a financial liability. Others thought it was a compound financial instrument, with equity and liability components. Some hedged their bets altogether by stating it was both an asset and a liability. A few thought it was an intangible asset. Others provided figures (some sort of amortised cost table) without ever stating what the transaction represented. Those candidates who did correctly identify the transaction as a financial asset generally said that it needed to be recognised at an initial £97,000 (ie including the transaction costs) and then amortised that figure at its effective interest rate, giving a closing carrying amount, although the answer did not always describe that method in words.

Issue (2): Much better attempts were made at this part of the question. Almost all candidates recognised this as a discontinued operation, although they didn't always explicitly state this, and correctly stated that it needed to be recognised as a single line in the statement of profit or loss. They then correctly combined their own figure for profit or loss on disposal with the subsidiary's loss for the year up to disposal. Most recognised that the loss for the year was for six months only, but a significant number of candidates, as usual, took only the group share of this figure. However, although almost all candidates attempted the relevant calculations, many, once again, failed to also describe what needed to be done in words. Few considered the impact of the disposal on the statement of financial position (ie the subsidiary would not be consolidated as control had been lost). By far the most common error in the calculation of the profit or loss on disposal was in respect of the non-controlling interest at disposal with very few calculating this using the chosen fair value policy – most candidates calculated this using the proportionate method and therefore simply took 20% of the net assets at disposal. Others made errors in the calculation of the latter figure, most commonly adding, rather than deducting, the loss for the year from the opening net assets.

Issue (3): Once again, many candidates produced the correct relevant calculations (this time often accompanied by journal entries, which were not required) without explaining why it was that the payable needed to be restated but that the inventory should not have been (ie making reference to the treatment of monetary, as opposed to non-monetary items). A minority of candidates said that the inventory had correctly been restated and that the payables correctly left at the historic rate. A significant number of candidates, whilst producing the three correct figures, seemed to be completely unclear as to which figures should be shown at which amount, ie at the historic or closing rate.

Issue (4): Most candidates recognised that this was a related party transaction and were able to explain why. However, most said that this was because Phillippe's wife was a related party, as opposed to Cuba Ltd being a related party. Almost all candidates listed the necessary disclosure requirements but fewer illustrated how these requirements would be fulfilled by reference to the information in the scenario. Most knew that the fact that the transaction had been made on an arm's length basis did not negate the need for disclosure.

Total possible marks Maximum full marks	33 21

(b) Ethical issues

Philippe appears to have a self-interest threat, as he is due a bonus based on the profit for the year. The "errors" which José has discovered in the draft financial statements could be genuine mistakes due to a lack of knowledge, or could be a deliberate attempt by Philippe to overstate the profit for the year in order to increase his bonus. It may be that had it not been for his illness that these "errors" would not have been discovered.

As an ICAEW Chartered Accountant Philippe has a duty of professional behaviour and due care and should be aware of the correct IFRS financial reporting treatment for all of these issues, none of which are at all controversial. His imminent retirement is no excuse.

Although the transaction with Grenada Ltd may all be above board, it does perhaps throw into doubt the integrity of Philippe if there is any question over whether the transactions were conducted on an arm's length basis. In any case, even if they were, as an ICAEW Chartered Accountant Philippe should not only act with integrity but he should *appear* to act with integrity. The fact that he is suggesting that this transaction does not need to be disclosed also paints him in a poor light.

Given Phillippe's attitude about not amending the figures, José is subject to an intimidation threat. He should apply the ICAEW Code of Ethics, with the following programme of actions:

- Explain to Philippe how each of these matters should be accounted for.
- If Philippe refuses to correct the errors, discuss the matters with the other directors to explain the situation and obtain support. Consider also discussing the issues with the external auditors.
- Obtain advice from the ICAEW helpline or local members responsible for ethics.
- Keep a written record of all discussions, who else was involved and the decisions made.

This part of the question was well answered. Most candidates correctly identified that there was a self-interest threat for Phillippe (because of his profit-related bonus) and that there was an intimidation threat for José (due to Phillippe's attitude in the telephone call). They also recognised that all of the "errors" had increased the profit for the year. Many then went on the discuss the actions that José should take, being the standard response of discussion with Phillippe, discussion with the other/managing director(s), seeking help from the ICAEW helpline, and documenting all discussions. As ever, many candidates were overly keen to resign and a number put themselves in an audit context, by suggesting that they should seek help from the ethics partner.

Total possible marks Maximum full marks	9 5

(c) IFRS v UK GAAP differences re disposal of subsidiary

IFRS	**UK GAAP**
IFRS 5 requires the results of a discontinued operation to be shown as a single figure on the face of the statement of profit or loss.	FRS 102 shows the results of a discontinued operation as a separate column on the face of the income statement.
Under IFRS 3 non-controlling interest may be measured at fair value or on the proportionate basis.	FRS 102 only permits the proportionate (share of ownership) basis.
IFRS 3 goodwill is not amortised but is subject to annual impairment reviews.	FRS 102 requires goodwill to be amortised over its useful life. There is a rebuttable presumption that the useful life should not exceed five years.

Almost all candidates scored at least one mark in this part, with the most common answer being to describe the differences between the presentation of discontinued activities in the statement of profit or loss/income statement, which was understandable as this was the main focus of Issue (2). However, Issue (2) also covered the calculation of goodwill and candidates should have been guided by the fact that the requirement was for two marks and that therefore they needed to think more widely and look at the calculation itself. Some candidates did go on to do this and achieve a second mark by describing which methods of calculating goodwill and the non-controlling interest are available under IFRS and UK GAAP. It was less common to see the differences with reference to the impairment and amortisation of goodwill, although this was not needed to achieve full marks.

Total possible marks	3½
Maximum full marks	2

Question 3

Total Marks: 19

General comments

This was a mixed topic question requiring the preparation of extracts from the financial statements. The question featured various transactions in property, plant and equipment, including a self-constructed asset, in addition to share issues during the year and dividends. In Part (a) candidates were required to explain their treatment of the self-constructed asset, which meant they could then use their calculated figures in Part (b).

Columbia plc

(a) IFRS financial reporting treatment of the manufacturing facility

Per IAS 16, Property, Plant and Equipment, the cost of an item of property, plant and equipment (PPE) comprises:

- Purchase price
- Costs directly attributable to bringing the asset to its intended location and condition.

The site preparation costs, materials and labour costs, professional fees, construction overheads and costs of the initial safety inspection are directly attributable costs and therefore can be capitalised, a total of £500,300 (100,000 + 358,300 + 10,000 + 21,000 + 11,000).

The relocation costs of £45,600 and the general overhead costs of £32,500 cannot be capitalised/should be expensed because they are not directly attributable. So the total amount written off to profit or loss should be £78,100 (45,600 + 32,500).

Capitalisation should cease when the asset becomes capable of operating in the manner intended /so on 30 November 2014.

Each significant part of an item of PPE should be depreciated separately so the calculation of the annual depreciation charge for the year will be:

	£
Safety inspection (21,000 ÷ 3)	7,000
Other ((500,300 – 21,000) ÷ 20)	23,965
	30,965

Since the asset was available for use only from 30 November 2014, then only one month of this annual charge should be recognised in profit or loss for the year ended 31 December 2014, ie £2,580 (30,965 ÷ 12).

The carrying amount of the facility on 31 December 2014 is therefore £497,720.

Answers to this part were mixed, although a reasonable number of candidates did obtain the maximum marks and, generally, the quality of explanations in this part was better than those in Part (a) of Question 2. However, a significant number of candidates wasted time by discussing irrelevant accounting standards, in particular IAS 38, Intangible Assets and IAS 23, Borrowing Costs. Most candidates made an attempt at justifying which costs should and shouldn't be capitalised and virtually all candidates did conclude that a month's worth of depreciation should be charged and attempted to calculate this figure. The most common errors were:

- failing to justify the appropriate treatment for the costs by reference to IAS 16, Property, Plant and Equipment
- treating the professional fees and/or the construction overheads and/or the initial safety inspection costs incorrectly
- not separating out the initial safety inspection costs so that they could be depreciated over the shorter life of three years.

Total possible marks	7½
Maximum full marks	5

(b) (i) Revised profit for the year ended 31 December 2014

	£
Draft profit for the year	52,600
Costs re self-constructed asset (a)	(78,100)
Depreciation on self-constructed asset (a)	(2,580)
Finance costs (50,000 x 4% x ½)	(1,000)
	(29,080)

(ii) Extracts from the financial statements for the year ended 31 December 2014

Statement of cash flows for the year ended 31 December 2014

	£
Investing activities	
Purchase of property, plant and equipment (W1)	(932,800)
Proceeds from sale of property, plant and equipment (125,700 – 14,300)	111,400
Financing activities	
Issue of ordinary share capital (75,000 x 1.50)	112,500
Issue of irredeemable preference share capital	50,000
Ordinary dividends paid (W2))	(56,250)

Statement of financial position as at 31 December 2014

	£
Non-current assets	
Property, plant and equipment (W1)	2,025,620
Equity	
Ordinary share capital (W3)	468,750
Retained earnings (W2)	39,220
Non-current liabilities	
Irredeemable preference share capital	50,000
Current liabilities	
Preference dividend/finance costs payable	1,000

Workings

(1) PPE

	£		£
B/d	1,456,700	Disposal	125,700
Additions (432,500 + 500,300 (a))	932,800	Depreciation (235,600 + 2,580 (a))	238,180
		C/d (β)	2,025,620
	2,389,500		2,389,500

(2) Retained earnings

	£		£
Loss for the year (i)	29,080	B/d	145,800
Bonus issue (93,750 – 72,500) (W3)	21,250		
Ordinary dividend (15p x 375,000)	56,250		
C/d (β)	39,220		
	145,800		145,800

(3) Ordinary share capital and share premium

	Share capital £	Share premium £
At 31 December 2013	300,000	35,000
Issue on 1 February 2014	75,000	37,500
	375,000	72,500
Bonus issue on 1 November 2014 (÷ 4)	93,750	(72,500)
At 31 December 2014	468,750	-

Generally answers to this part were good with most candidates calculating an adjusted profit figure and preparing extracts to both the statement of financial position and statement of cash flows. The quality of extracts produced was reasonable, but a minority of candidates produced a jumble of notes and workings.

Many candidates correctly calculated the closing balance on the share capital account and showed in their workings that the share premium account would be reduced to zero. The figures for proceeds from disposals of property, plant and equipment, issue of shares and dividends paid were also dealt with well and nearly always shown under the correct heading in the statement of cash flows. However, as always with the statement of cash flows, many candidates lost marks for failing to show outflows of cash in brackets. This is an issue that has been flagged up repeatedly. Also, many candidates wasted time by duplicating workings; often doing a bracketed working for property, plant and equipment to calculate the figure for the statement of financial position then also producing a T-account working (which often included different numbers). Another common error with property, plant and equipment was to include the costs of the new manufacturing facility in the working but not in the figure on the face of the statement of cash flows. Other candidates wasted time by preparing a combined share capital and share premium T-account then had to repeat the working, showing these accounts separately, to allow for the preparation of statement of financial position extracts. A worrying minority of candidates calculated a weighted average number of ordinary shares, as would be needed for an earnings per share calculation.

Other common errors included:

- including a full year for the dividend on the irredeemable preference shares (rather than six months) and also treating it as a dividend paid on the statement of cash flows, or omitting this dividend entirely
- making unnecessary adjustments to both profit and property, plant and equipment (when the question clearly stated that the depreciation on existing assets and the loss on the disposal had already been recognised)
- deducting all of the bonus issue from retained earnings when as much of it as possible should have been taken to share premium (another reason why it was necessary to produce separate share capital and share premium workings)
- calculating the ordinary dividend by reference to closing share capital (when the bonus issue had not been made until after the interim dividend was paid)
- combining the liabilities for the preference dividend payable with the preference share capital in the statement of financial position, rather than showing these individually as current and non-current liabilities respectively.

Total possible marks	14½
Maximum full marks	14

Question 4

Total Marks: 20

General comments

This question required the preparation of a consolidated statement of financial position from a draft version of the same, where figures for a subsidiary had been incompletely incorporated and figures for an associate not included at all. Fair value adjustments were required on acquisition for both companies as well as dealing with contingent consideration for the subsidiary. Intra-group trading and the transfer of a non-current asset had occurred during the year and also needed to be adjusted for.

Dominica plc

Consolidated statement of financial position as at 31 December 2014

	£	£
Assets		
Non-current assets		
Property, plant and equipment (3,780,400 – 20,000 (W7))		3,760,400
Investment in associate (W4)		160,060
Goodwill (W2)		108,830
		4,029,290
Current assets		
Inventories (400,800 + 8,500 (W1) + 17,700 (W1))	427,000	
Trade and other receivables	182,400	
Cash and cash equivalents	53,400	
		662,800
Total assets		4,692,090
Equity and liabilities		
Equity		
Ordinary share capital (1,400,000 – 160,000)		1,240,000
Share premium (890,000 – 80,000)		810,000
Revaluation surplus (1,061,600 – 240,000 + (100,000 (W1) x 85%))		906,600
Retained earnings (W5)		1,228,835
Attributable to the equity holders of Dominica plc		4,185,435
Non-controlling interest (W3)		103,155
		4,288,590
Current liabilities		
Trade and other payables (320,000 – 200,000)	120,000	
Contingent consideration	150,000	
Taxation	133,500	
		403,500
Total equity and liabilities		4,692,090

Workings

(1) Net assets – Tobago Ltd

	Year end	Acquisition	Post acq
	£	£	£
Ordinary share capital	160,000	160,000	-
Share premium	80,000	80,000	-
Revaluation surplus	240,000	140,000	100,000
Retained earnings	181,500	63,200	
FV adj – inventories ((124,000 – 107,000)/2)	8,500	17,000	
Inventory – sale or return (23,600 x 75%)	17,700	-	127,500
	687,700	460,200	227,500

(2) Goodwill – Tobago Ltd

	£
Consideration transferred:	
Cash	400,000
Contingent consideration	100,000
	500,000
Net assets at acquisition (W1)	(460,200)
Non-controlling interest at acquisition (460,200 (W1) x 15%)	69,030
	108,830

(3) Non-controlling interest – Tobago Ltd

	£
Share of net assets at acquisition (460,200 (W1) x 15%)	69,030
Share of post-acquisition profits (227,500 (W1) x 15%)	34,125
	103,155

(4) Investment in associate – Anguilla Ltd

	£
Cost	156,000
Add: Share of post-acquisition profits ((168,100 – 104,500) x 35%)	22,260
Less: FV depreciation (100,000/20 years) x 35% x 10 years)	(17,500)
Less: PURP (W6)	(700)
	160,060

(5) Retained earnings

	£
Draft consolidated (1,367,900 – 181,500)	1,186,400
Additional contingent consideration	(50,000)
Tobago Ltd (127,500 (W1) x 85%)	108,375
Anguilla Ltd (W4)	22,260
Less: FV depreciation (W4)	(17,500)
Less: PURP (W6)	(700)
Less: PPE PURP (W7)	(20,000)
	1,228,835

(6) PURP

	%	Anguilla Ltd £
SP	100	20,000
Cost	(70)	14,000
GP	30	6,000
X 1/3		2,000
Anguilla Ltd x 35%		700

(7) PPE PURP

	£
Asset now in Tobago Ltd's books at 180,000 x 5/6 years	150,000
Asset would have been in Dominica plc's books at 156,000 x 5/6 years	(130,000)
	20,000

Answers to this question were generally good, with virtually all candidates recognising that the associate should not be consolidated and that the equity balances needed to be adjusted to remove the figures of the subsidiary that had been incorrectly added in. Most candidates produced the standard workings used in the learning materials which meant it was relatively straightforward to follow the workings and give credit where appropriate. The correct figure for the unrealised profit relating to the associate was frequently calculated correctly although, as always, some candidates failed to use only the parent's share of this. Many candidates also seemed confused about what should be included in the associate working, often adding in fair value adjustments and not understanding that adjustments to the cost of the associate should also be included in retained earnings. A number of candidates calculated different figures for these two workings thereby wasting time and losing marks.

The two adjustments that caused the most problems were the unrealised profit relating to the sale of a machine and the adjustment to inventory for goods sold on a sale or return basis. With regard to the former those candidates who calculated the adjustment by comparing the two different carrying amounts did well. However, those who calculated separate figures for profit on disposal and the adjustment to the subsequent depreciation charge rarely netted these off to come to the correct adjustment. Some candidates calculated the relevant figure but then failed to adjust property, plant and equipment for this.

Few candidates calculated the correct adjustment for the goods on sale and return often adjusting for the profit element (which had not been recognised) rather than calculating the cost of the goods and adding it to net assets and inventories. The contingent consideration was also poorly dealt with. Many candidates used the wrong figure in the goodwill calculation and few made the appropriate corresponding adjustment to liabilities or dealt with the change in the value of the contingent consideration in retained earnings.

As always, many candidates lost marks by failing to show an "audit trail" so figures appeared in workings without any evidence of how they had been calculated. It is not sufficient to say, for example, "85% x NA at acq". The actual figure for net assets at acquisition (as calculated in the candidate's own net assets table) must also clearly be shown alongside the percentage for the marks to be awarded.

Other common errors included the following:

- Deducting, rather than adding, the fair value increase relating to inventory and/or failing to recognise that half the inventory had been sold by the year end.
- Adopting an inconsistent treatment in the net asset working and the adjustment to inventories in respect of the above (eg adding the figure to net assets but deducting it from inventories).
- Not separating out the movement in net assets relating to the revaluation surplus and therefore including this in retained earnings.
- Not adjusting the revaluation surplus to take into account only the parent's share of the subsidiary's post-acquisition movement on its revaluation surplus – many candidates added in 100% of this figure, others did not adjust for it at all.
- Not knowing how to calculate and/or account for the post-acquisition depreciation on the fair value uplift in the associate. A significant number of candidates who were able to calculate the depreciation adjustment then only proceeded to account for one year's worth of the adjustment instead of the required ten years' worth.
- Using 80% when calculating figures for the subsidiary, instead of the 85% given in the question.

Total possible marks	22
Maximum full marks	20

PROFESSIONAL LEVEL EXAMINATION

MONDAY 17 MARCH 2014

(3 hours)

FINANCIAL ACCOUNTING AND REPORTING

This paper consists of **FIVE** written test questions (100 marks).

1. Ensure your candidate details are on the front of your answer booklet.
2. Answer each question in black ball point pen only.
3. Answers to each written test question must begin on a new page and must be clearly numbered. Use both sides of the paper in your answer booklet.
4. The examiner will take account of the way in which answers are presented.

Unless otherwise stated, make all calculations to the nearest month and the nearest £.

All references to IFRS are to International Financial Reporting Standards and International Accounting Standards.

IMPORTANT

Question papers contain confidential information and must NOT be removed from the examination hall.

DO NOT TURN OVER UNTIL YOU ARE INSTRUCTED TO BEGIN WORK

You MUST enter your candidate number in this box.

BLANK PAGE

1. Alloa Ltd operates in the electronics and computer software industry. The financial controller was in the process of preparing the end of year financial statements when he was suddenly taken ill. You have been passed the partially completed financial statements along with information on the outstanding issues.

Statement of financial position as at 30 September 2013 (draft)

ASSETS		
Non-current assets	**£**	**£**
Property, plant and equipment (Note 3)		90,800
Research and development (Note 4)		228,000
Patents (Note 5)		47,400
		366,200
Current assets		
Inventories (Note 6)	23,600	
Trade and other receivables	215,000	
Cash and cash equivalents	13,700	
		252,300
Total assets		618,500
EQUITY AND LIABILITIES		
Equity		
Ordinary share capital (£1 shares) (Note 8)		185,000
Share premium (Note 8)		88,750
Preference shares (Note 7)		50,000
Retained earnings		263,950
		587,700
Current liabilities		
Trade and other payables		30,800
Total equity and liabilities		618,500

Statement of profit or loss for the year ended 30 September 2013 (draft)

	£
Revenue (Note 1)	899,524
Cost of sales	(422,590)
Gross profit	476,934
Operating expenses	(312,000)
Operating profit	164,934
Investment income (Note 2)	71,200
Profit before tax	236,134
Income tax (Note 9)	3,000
Profit for the year	239,134

The following additional information is available:

(1) Alloa Ltd sold goods on 1 October 2012 for £200,000 with a one year interest-free credit period and the full amount was included in sales and trade receivables. Alloa Ltd normally offers credit terms to customers at a rate of 5% pa.

(2) Alloa Ltd launched new software in November 2012. The software is sold via third party companies with Alloa Ltd receiving royalty payments of 15% on all of these sales. Monthly reports are provided to Alloa Ltd by the third party sellers 30 days after the end of each month. Alloa Ltd records royalty income as part of investment income when the reports are received. Third party reports showed total sales of £48,000 for the month of September 2013, although no amounts have yet been recorded by Alloa Ltd in respect of these sales.

(3) Property, plant and equipment is measured under the cost model and is depreciated using the reducing balance method at a rate of 30% pa. Depreciation should be presented in cost of sales. The balance in the draft statement of financial position is the carrying amount at 1 October 2012.

(4) During the year £228,000 was spent on research and development of two new software products, Uig and Brora. The breakdown of expenditure was:

	£
Research into product development	26,000
Development activities – Uig	118,000
– Brora	68,500
Pre-launch testing of Uig	9,600
Staff training	5,900
	228,000

On 1 October 2012 Uig was considered to be commercially viable. Uig was launched on 1 April 2013 and has been selling well. It is estimated that Uig will have a useful life of two years at which point technological advances are likely to have been made which will make the product obsolete. Uig's development costs were incurred between 1 October 2012 and 31 March 2013.

Brora has yet to be launched and requires additional development before it can be reasonably expected to generate probable future economic benefits.

All expenses relating to intangible assets should be presented in cost of sales.

(5) Alloa Ltd acquired the patents early in 2012, all of which are for two years. No new patents were acquired during the year ended 30 September 2013. A patent which had cost £3,000 on 1 May 2012 was sold on 30 April 2013 at its carrying amount. The cash proceeds were debited to cash and credited to cost of sales.

The balance included in the draft statement of financial position is the carrying amount at 1 October 2012, which consists of cost of £59,000 and accumulated amortisation of £11,600.

(6) Inventories were valued at £25,500 on 30 September 2013. The balance shown in the draft statement of financial position is opening inventories at 1 October 2012 as the year-end inventory valuation had not been finalised when the draft financial statements were prepared. No adjustments for opening or closing inventories have been included in the draft figure for cost of sales.

(7) On 1 October 2012 Alloa Ltd issued 50,000 4% £1 preference shares at par. These shares are redeemable on 30 September 2018 at a premium. The preference dividend for the year was paid on 30 September 2013 and has been debited to retained earnings. The effective interest rate is 4.8% pa.

(8) Alloa Ltd entered into a share buyback scheme in June 2013. It reacquired 15,000 £1 ordinary shares for £1.75 cash per share. The total cash paid was debited to share capital and share premium based on this nominal value and premium per share.

(9) The income tax liability for the year ended 30 September 2013 has now been estimated at £17,000. The amount shown in the draft statement of profit or loss is the balance remaining on the nominal ledger after paying the liability at 30 September 2012, which was settled at less than originally estimated.

The finance director has heard about IFRS 7, Financial Instruments: Disclosures, but is unsure what the standard is really about.

Requirements

(a) Prepare the following for Alloa Ltd, in a form suitable for publication:

(i) a statement of profit or loss for the year ended 30 September 2013;

(ii) a statement of financial position as at 30 September 2013;

(iii) a note to the financial statements showing the movements on intangible assets for the year ended 30 September 2013. A total column is **not** required. No other notes to the financial statements are required. **(23 marks)**

(b) Explain to the finance director the objectives of IFRS 7. **(2 marks)**

(c) The IASB's Conceptual Framework refers to the enhancing qualitative characteristics. Explain how these ensure that financial statements are useful to users. **(5 marks)**

(30 marks)

2. Limerigg plc has a number of subsidiary companies. On 1 December 2012 Limerigg plc sold its 70% holding in Brightons Ltd for cash of £62,000. There were no other changes in the composition of the group during the year ended 30 September 2013.

Extracts from the group's consolidated statement of profit or loss for the year ended 30 September 2013 and consolidated statement of financial position as at that date are set out below together with some additional information.

Extract from consolidated statement of profit or loss for the year ended 30 September 2013

	£
Profit attributable to:	
Owners of Limerigg plc	202,900
Non-controlling interest	42,900
	245,800

Extract from consolidated statement of financial position as at 30 September

	2013 £	2012 £
Non-current assets		
Property, plant and equipment	861,405	506,950
Equity		
Ordinary share capital (£1 shares)	550,000	350,000
Share premium account	78,000	35,000
Retained earnings	132,130	96,430
Revaluation surplus	72,000	–
Non-controlling interest	73,845	97,600

Additional information:

(1) The reconciliation of profit before tax to cash generated from operations has been partially completed using the indirect method, giving a draft figure for cash generated from continuing and discontinued operations of £396,675. This figure has been calculated making all of the relevant adjustments other than any relating to property, plant and equipment.

At the date of disposal, Brightons Ltd's statement of financial position showed property, plant and equipment at £76,900, cash and cash equivalents of £2,300 and total net assets of £77,850.

(2) On 1 February 2013 Limerigg plc made a 1 for 5 bonus issue of ordinary shares, utilising the share premium account as far as possible. On 31 July 2013 an issue of ordinary shares for cash at market value was made.

(3) During the year the Limerigg plc group acquired a number of new items of plant and equipment for cash, made no disposals, other than through the disposal of Brightons Ltd, and charged depreciation of £101,000. A building was revalued to £325,000 for the first time on 1 October 2012 and this was the only revaluation to take place in the year. The building had originally cost £300,000 on 1 October 2007 and is being depreciated straight-line over its estimated useful life of 30 years. Limerigg plc made an annual transfer between the revaluation surplus and retained earnings in accordance with best practice.

(4) Limerigg plc and one subsidiary company paid interim dividends during the year.

Requirement

Prepare extracts from Limerigg plc's consolidated statement of cash flows for the year ended 30 September 2013 showing figures under the following headings:

(i) Cash generated from operations

(ii) Cash flows from investing activities

(iii) Cash flows from financing activities

(11 marks)

3. Melloch plc operates in the electronics sector and has investments in a number of subsidiaries. The financial controller has prepared draft consolidated financial statements for the year ended 30 September 2013.

Draft consolidated profit attributable to Melloch plc's shareholders for the year ended 30 September 2013 was £978,400.

In order to allow the financial statements to be finalised, information on the following issues has been provided:

(1) On 1 December 2012 Melloch plc received a £540,000 government grant to contribute towards research expenditure on a new micro-chip which will be used in the latest medical technology. The conditions of the grant mean that Melloch plc must use the grant over the next two years from the date of receipt on this specified area of research, otherwise the grant will become repayable.

The full grant was recognised as 'revenue' at 30 September 2013 as the directors believe that the full amount will be spent by the end of the two year period and hence no amount will need to be repaid. The relevant expenditure will be incurred evenly over the period.

(2) On 1 April 2013 Melloch plc acquired 80% of the ordinary share capital of Sheardale Ltd for consideration of £480,000 and associated costs of £8,000. The fair value of Sheardale Ltd's net assets at 1 April 2013 was £575,000. This excluded contractual rights owned by Sheardale Ltd, as these rights are not capable of being sold separately from the business and therefore have not been recognised by Sheardale Ltd in its financial statements. These contractual rights have been valued at £75,000 by an independent valuer and have an estimated useful life of three years.

Sheardale Ltd uses the proportionate method for measuring the non-controlling interest and goodwill on acquisition.

Sheardale Ltd made a loss for the year ended 30 September 2013 of £180,000, which accrued evenly over the year.

The only accounting entries made were to recognise the cash paid, so £488,000 was debited to investments being the cash consideration plus the costs incurred.

(3) In early September 2013 Melloch plc undertook an impairment review of one of its research centres as a number of its key projects had been superseded by advances made by one of Melloch plc's key competitors. Melloch plc is unsure whether the centre should be sold for development or whether different projects should be moved to the centre.

The carrying amount of the research centre was £1,400,000 at 30 September 2013 and its estimated value in use at that date was £1,100,000. The research centre is measured under the revaluation model and to date £100,000 has been credited to the revaluation surplus in respect of the centre. Melloch plc received an offer for the land on which the research centre sits of £1,250,000, for development purposes. Legal costs of £5,000 would be associated with the sale.

(4) During September 2013 Melloch plc sold one of its vehicles to the marketing director. The vehicle had a carrying amount of £15,000 at the date of sale and the marketing director paid the full fair value which was estimated at £17,500. The profit on the sale was reported as part of profit or loss for the period, although the amount remained unpaid at 30 September 2013.

Melloch plc had 280,000 £1 ordinary shares in issue on 1 October 2012. On 1 December 2012 Melloch plc issued 70,000 ordinary shares for cash at market price. On 1 April 2013 a 1 for 5 bonus issue was made.

Requirements

(a) Explain the required IFRS accounting treatment of the four issues above in the consolidated financial statements of Melloch plc for the year ended 30 September 2013, preparing all relevant calculations. **(17 marks)**

(b) Using your results from Part (a) calculate the revised consolidated profit attributable to Melloch plc's shareholders for the year ended 30 September 2013. **(3 marks)**

(c) Using your results from Part (b) calculate basic earnings per share for the year ended 30 September 2013. **(3 marks)**

(d) Describe any differences between IFRS and UK GAAP in respect of the financial reporting treatment of the four issues above. Supporting calculations are **not** required. **(5 marks)**

(28 marks)

4. Bainsford plc manufactures wooden flooring and has a number of factories across the UK. Nia, an ICAEW Chartered Accountant, is the financial controller of Bainsford plc.

The financial statements for the year ended 30 September 2013 have been prepared in draft by Nia's assistant, with the help of the finance director, whilst Nia was away on a training course. Draft profit before tax is £497,300, draft current assets are £275,850 and draft current liabilities are £141,700.

After a number of discussions with various departments Nia discovered the following additional information.

(1) A temporary supervisor was appointed at Bainsford plc's Airth factory which has led to a number of issues over the year-end inventory valuation.

Raw materials
The temporary supervisor used average cost to value the 1,200m^2 of hardwood held in the warehouse at 30 September 2013 although the first-in first-out basis should have been used to value this inventory.

Invoices show hardwood acquired during the year as follows:

Date	**Quantity (m^2)**	**Price £ (per m^2)**
10 October 2012	5,000	£74
6 January 2013	6,000	£65
15 June 2013	4,000	£80

Finished goods
7,500m^2 of Grade A flooring held at 30 September 2013 was included in year-end inventory using a fixed production costs absorption rate of £1.50 per m^2. The £1.50 was calculated based on the following information:

	£
Maintenance of factory	0.40
Salaries of factory personnel	0.50
Depreciation of manufacturing equipment	0.20
Storage costs of the finished goods	0.25
Advertising costs	0.15
	1.50

(2) Bainsford plc is having a new manufacturing plant built. On 1 January 2013 to finance the construction, Bainsford plc sold its current manufacturing facility for £1,150,000 when it had a carrying amount of £900,000 and an estimated fair value of £775,000. However, while construction takes place, Bainsford plc is continuing to use its existing facility under a one year lease, paying above market value rentals. The manufacturing facility was removed from non-current assets and a profit of £250,000 was recognised (being proceeds less carrying amount). The lease payments were correctly accounted for.

Nia is worried that there might be some inappropriate accounting taking place as she has heard rumours that Bainsford plc is looking for new finance through a public listing and therefore the directors are keen to report an exceptional trading year. Nia also has some information and she is not sure what she should do with it.

She was out with friends when she heard one of them, Sam, talking about his employer, a listed competitor company to Bainsford plc. The competitor company is likely to fall short of its earnings target for the current year.

Requirements

(a) (i) Calculate revised figures from Bainsford plc's statement of financial position as at 30 September 2013 for current assets and current liabilities.

(ii) Calculate revised profit before tax for Bainsford plc for the year ended 30 September 2013.

(9 marks)

(b) Discuss the ethical issues arising from the scenario, explaining any action Nia should take.

(5 marks)

(14 marks)

PLEASE TURN OVER

5. At 1 October 2012 Cambus plc had investments in two companies: a 65% holding in Ochill Ltd and a 40% holding in Izat Ltd, which is a joint venture.

On 1 April 2013 Cambus plc purchased 80% of the ordinary shares of Kennet Ltd, which had retained earnings of £82,500 at this date. Cambus plc measures all non-controlling interest and goodwill on acquisition using the proportionate method.

Extracts from the draft individual financial statements of the four companies for the year ended 30 September 2013 are shown below:

Statements of profit or loss

	Cambus plc £	Ochill Ltd £	Kennet Ltd £	Izat Ltd £
Revenue	1,285,300	579,000	432,500	123,700
Cost of sales	(418,200)	(236,200)	(165,300)	(37,920)
Gross profit	867,100	342,800	267,200	85,780
Operating expenses	(267,500)	(172,000)	(122,400)	(26,300)
Profit from operations	599,600	170,800	144,800	59,480
Investment income	48,750	–	–	–
Profit before tax	648,350	170,800	144,800	59,480
Income tax expense	(130,000)	(34,200)	(28,900)	(14,855)
Profit for the year	518,350	136,600	115,900	44,625

Statements of financial position (extracts)

	Cambus plc £	Ochill Ltd £	Kennet Ltd £	Izat Ltd £
Equity				
Ordinary share capital (£1 shares)	500,000	300,000	280,000	150,000
Retained earnings	461,200	296,400	140,450	225,500
	961,200	596,400	420,450	375,500

Additional information:

(1) Cambus plc acquired its holding in Ochill Ltd on 1 October 2007 when Ochill Ltd's retained earnings were £153,700. The fair values of all Ochill Ltd's assets and liabilities at the date of acquisition were the same as their carrying amounts, with the exception of a freehold property which was estimated to have a fair value of £100,000 in excess of its carrying amount. This property was assessed as having a remaining useful life of 25 years at 1 October 2007. Depreciation of freehold property is presented in operating expenses.

(2) Cambus plc acquired its holding in Izat Ltd a number of years ago for £180,000 when Izat Ltd's retained earnings were £96,000.

(3) Between 1 April 2013 and 30 September 2013 Ochill Ltd invoiced £36,000 and £27,000 of sales to Cambus plc and Kennet Ltd respectively at a mark-up of 20%. Half of these goods were still held by Cambus plc at the year end, although Kennet Ltd had sold all of the goods which it had purchased.

(4) All revenues and costs accrued evenly over the year.

(5) Cambus plc and Ochill Ltd paid dividends of 50p and 25p per share respectively during the year ended 30 September 2013.

(6) There have been no impairments of goodwill. However, an impairment of £5,000 needs to be recognised against Cambus plc's investment in Izat Ltd.

Requirement

Prepare, for Cambus plc for the year ended 30 September 2013:

(i) a consolidated statement of profit or loss;

(ii) an extract from the consolidated statement of changes in equity, showing only the retained earnings and non-controlling interest columns.

(17 marks)

MARK PLAN AND EXAMINER'S COMMENTARY

The mark plan set out below was that used to mark these questions. Markers are encouraged to use discretion and to award partial marks where a point was either not explained fully or made by implication. More marks are available than could be awarded for each requirement, where indicated. This allows credit to be given for a variety of valid points, which are made by candidates.

Question 1

Overall marks for this question can be analysed as follows: **Total: 30**

General comments
This question presented a draft set of financial statements with some adjustments. Candidates were required to prepare the amended statement of profit or loss, statement of financial position and the intangible assets table. A number of adjustments were required to be made, including depreciation, research and development expenditure, revenue adjustments, treasury shares and redeemable preference shares.

Part b) required candidates to explain the purpose and objectives of IFRS 7 Financial Instruments; Disclosures.

Part c) featured the concepts requirement which asked about the enhancing qualitative characteristics.

Alloa Ltd – Statement of financial position as at 30 September 2013		
	£	**£**
ASSETS		
Non-current assets		
Property, plant and equipment (W5)		63,560
Intangible assets (95,700 + 17,025)(note)		112,725
		176,285
Current assets		
Inventories	25,500	
Trade and other receivables (215,000 + 7,200)	222,200	
Cash and cash equivalents	13,700	
		261,400
Total assets		437,685
Equity		
Ordinary share capital (185,000 + 15,000)	200,000	
Share premium (88,750 + (15,000 x 0.75))	100,000	
Treasury shares (15,000 x £1.75)	(26,250)	
Retained earnings (W7)	65,735	
Equity		339,485
Non-current liabilities		
Redeemable preference shares		50,400
Current liabilities		
Trade and other payables	30,800	
Taxation	17,000	
		47,800
Total equity and liabilities		437,685

Alloa Ltd – Statement of profit or loss for the year ended 30 September 2013

	£
Revenue (W2)	890,000
Cost of sales (W1)	(610,605)
Gross profit	279,395
Operating expenses	(312,000)
Operating loss	(32,605)
Investment income (71,200 + (48,000 x 15%) + 9,524 (W2))	87,924
Finance charges (W6)	(2,400)
Profit before tax	52,919
Income taxation (3,000 – 17,000)	(14,000)
Net profit for the period	38,919

Notes to the financial statements as at 30 September 2013
Intangible asset

	Development costs	Patents
Cost	£	£
At 1 October 2012	–	59,000
Additions	127,600	
Disposals	–	(3,000)
At 30 September 2013	127,600	56,000
Amortisation		
At 1 October 2012	–	11,600
Charge for year (W3 & W4)	31,900	28,875
Disposals	–	(1,500)
At 30 September 2013	31,900	38,975
Carrying amount		
At 30 September 2012	–	47,400
At 30 September 2013	95,700	17,025

W1 Expenses

	Cost of sales
Trial balance	422,590
Opening inventories	23,600
Closing inventories	(25,500)
R&D expenditure (W3)	100,400
R&D amortisation (W3)	31,900
Patent amortisation (W4)	28,875
Disposed of patent (3,000 – (3,000 / 2yrs))	1,500
Depreciation charge – plant & machinery (W5)	27,240
	610,605

W2 Revenue

	£
Trial balance	899,524
Interest free credit (200,000 – (200,000/1.05))	(9,524)
At 30 September 2013	890,000

W3 Research & development expenditure

	£	£
Trial balance		228,000
Less amounts charged to profit & loss		
Staff training	5,900	
Research costs	26,000	
Development of the Brora	68,500	
		(100,400)
Intangible asset at 30 September 2013		127,600
Amortisation (127,600 / 2yrs x 6/12)		(31,900)
		95,700

W4 Patents

	£	£
Amortisation charge for year		
(59,000 – 3,000) / 2yrs	28,000	
Disposed of paten (3,000 / 2yrs x 7/12)	875	
		(28,875)

W5 Plant and equipment

	£
Carrying amount at 1 Oct 2012	90,800
Depreciation charge for the year (90,800 x 30%)	(27,240)
	63,560

W6 Redeemable preferences shares

	Opening balance	Interest exp (4.8%)	Interest paid (4%)	Closing balance
	£	£	£	£
30 Sept 2013	50,000	2,400	(2,000)	50,400

W7 Retained earnings

	£
Per draft	263,950
Less: draft profit and loss	(239,134)
Add: revised profit and loss	38,919
Add back preference dividend (50,000 x 4%)	2,000
	65,735

Presentation was generally good, although the presentation of the statement of profit or loss was almost always better than that of the statement of financial position where sub-totals were, as usual, often missing for one or more categories. Most candidates correctly showed the treasury shares as a “negative” balance under equity.

Presentation of the intangible asset note was more varied with candidates often merging the patents and development costs into one column and/or netting off cost and amortisation. Only a very small minority of candidates failed to make any attempt at the note.

The vast majority of candidates used a “costs matrix” to calculate the figure for cost of sales and, on the whole, it was possible to match figures on the face of the financial statements to workings. Almost all candidates correctly calculated the depreciation charge on property, plant and equipment and included this figure in cost of sales, and the carrying amount on the statement of financial position. Weaker candidates put the carrying amount both on the statement of financial position and added it to cost of sales.

The adjustments for opening and closing inventories were generally dealt with correctly and pleasingly many candidates also calculated the tax charge correctly (although not all then went on to include the correct figure in current liabilities). Disappointingly very few candidates managed to calculate the discount on the deferred revenue correctly and even those who did very rarely then recognised the related financing income (even though this issue was almost identical to worked examples in the study manual). Most candidates included the correct figure for royalty income in the statement of profit or loss, but few completed the double entry by also adding this to trade and other receivables.

Surprisingly many candidates also struggled with the redeemable preference shares. Even those who wrote out the "table" working showing the correct interest expense and cash paid often then went on to put the wrong figures in the statement of profit or loss and/or the statement of financial position. However most did recognise that the transaction should be treated as a liability rather than equity. Strangely a number of candidates treated the shares as convertible debt and wasted significant time discounting the future payments to arrive at separate debt and equity elements.

Rather disappointingly relatively few candidates calculated the correct figures for development costs and patents. Candidates were often "inconsistent" such as by including some costs twice (ie both capitalising and expensing them) or by calculating amortisation on a different figure to the one capitalised.

Common errors in other areas included the following:

- Deducting the treasury shares elements from share capital and premium, instead of adding them and/or showing the treasury shares themselves as a credit balance, instead of a debit.
- Failing to reduce retained earnings by the draft profit for the year, having increased it by the profit for the year calculated in the revised statement of profit or loss.
- Failing to capitalise the correct elements of the research and development expenditure.
- Basing amortisation for the year on the capitalised development costs on one year instead of six months.
- Incorrectly calculating accumulated amortisation on the patent disposed of during the year (or failing to charge amortisation on that patent up to the point of disposal).
- Failing to adjust cost of sales for the proceeds on disposal of the patent or making the adjustment in the wrong direction.
- In the costs of sales matrix including either the amortisation on the patent or on the capitalised development costs, but not both.
- Capitalising the Brora development costs, even though the project had not yet met the IAS 38 criteria.

Total possible marks Maximum full marks	25½ 23

(b)

IFRS 7 Financial Instruments: Disclosure, was published because the IASB felt that existing standards that covered financial instruments needed to be improved. Improvements were needed to ensure that the disclosure of information on financial instruments provided greater transparency of information so that users could better assess the risks that an entity was exposed to.

The objective of IFRS 7 is to require entities to provide disclosures in their financial statements which enable users to evaluate both the significance of financial instruments for the entity's financial position and performance, and the nature and extent of the risks arising from the financial instruments and how the entity manages those risks.

Most candidates who made an effort with this requirement made a reasonable attempt by reciting the objectives of IFRS 7 from their open book text. Few candidates went beyond this.

Total possible marks Maximum full marks	3 2

(c) Enhancing qualitative characteristics

Usefulness
There are four enhancing qualitative characteristics which enhance the usefulness of information that is relevant and faithfully represented. These are: comparability, verifiability, timeliness and understandability.

Comparability ensures that users can identify and understand similarities in, and differences among, items. Information about a reporting entity is more useful if it can be compared from one reporting period to the next and with similar information from other entities. Comparability allows this.

Consistency, although not an enhancing qualitative characteristic itself is related to comparability. This relates to the same methods being used to report the same item, so consistent accounting policies governed by accounting standards. The disclosure of accounting policies is therefore key to ensure that users can make a valid comparison between items.

Verifiability helps assure users that information faithfully represents the information provided – it provides credibility to the financial information. It means that different knowledgeable and independent observers could reach consensus that a particular depiction is a faithful representation.

Timeliness is equally important as information becomes less useful the longer the time delay in reporting it. Timeliness means that information is available to investors, lenders and other creditors in time for it to be used in their decision making processes.

Finally, the characteristic of *understandability* means that information that may be difficult to understand is made more useful by presenting and explaining it as clearly as possible. Whilst financial information should be presented clearly and in an understandable manner, it is expected that users of the financial statements have a reasonable level of knowledge and understanding. It would be misleading to exclude information simply because of its complex nature, as this would lead to incomplete information which would be misleading to users.

There is a balance between timeliness and the provision of reliable information. For example, a provision has uncertainty involved in it, if an entity waits to report this information then it may have been settled and therefore the uncertainty over its amount will disappear. This information is therefore more reliable the longer an entity waits to report it. However, if such information is not reported until say six months after the year end then the information is less useful to users.

As with Part (b), most candidates picked up some marks by using their open book text, correctly identifying the four enhancing qualitative characteristics and making a brief point about each. The depth of explanation was variable. Others wasted time by also discussing the primary qualitative characteristics or other concepts.

Total possible marks	8½
Maximum full marks	5

Question 2

Overall marks for this question can be analysed as follows: **Total: 11**

General comments

This question required extracts from a consolidated statement of cash flows where a subsidiary had been disposed of during the year. Candidates were required to calculate the cost of additions to revalued property, plant and equipment, dividend payments by the parent and a subsidiary company and the proceeds from the issue of shares (following a bonus issue).

Limerigg plc

Statement of cash flows for the year ended 30 September 2013

	£	£
Cash generated from operations		497,675
Cash flows from investing activities		
Purchase of property, plant and equipment (W1)	(457,355)	
Disposal of subsidiary (62,000 – 2,300)	59,700	
Cash flows from financing activities		
Proceeds from issue of ordinary share capital (130,000 + 78,000) (W2 & W3)	208,000	
Non-controlling interest dividend (W5)	(43,300)	
Dividends paid (W4)	(135,200)	

Working

	£
Draft cash generated from operations (continuing & discontinued)	396,675
Depreciation	101,000
Cash generated from operations	497,675

Property revaluation

	£
Carrying amount at 1 October 2012 (300,000 – ((300,000 / 30yrs) x 5yrs))	250,000
Revalued amount	325,000
Revaluation surplus	75,000

Workings

(1) PPE

	£		£
B/d	506,950	Disposal of subsidiary	76,900
Revaluation (W)	75,000	Depreciation	101,000
Additions (β)	457,355	C/d	861,405
	1,039,305		1,039,305

(2) Share capital

	£		£
		B/d	350,000
		Bonus issue (350,000 / 5)	70,000
C/d	550,000	Cash issue (β)	130,000
	550,000		550,000

(3) Share premium

	£		£
Bonus issue	35,000	B/d	35,000
C/d	78,000	Cash issue (β)	78,000
	113,000		113,000

(4) Retained earnings

	£		£
Dividends paid (β)	135,200	B/d	96,430
Bonus issue (70,000 – 35,000)	35,000	Revaluation surplus – transfer (75,000 – 72,000)	3,000
C/d	132,130	Profit or loss	202,900
	302,330		302,330

(5) Non-controlling interest

	£		£
Dividends paid (β)	43,300	B/d	97,600
Disposal (77,850 x 30%)	23,355		
C/d	73,845	Profit or loss	42,900
	140,500		140,500

A number of candidates achieved full marks on this question and a pleasing number calculated the correct figures for the cash inflow from the disposal of the subsidiary, purchase of property, plant and equipment and for the dividend paid to the non-controlling interest. Most correctly adjusted cash generated from operations for the depreciation charge although many often also made other unnecessary adjustments.

A significant number of candidates lost marks by failing to show brackets round figures which represent an outflow of cash. Candidates should be aware that this convention is just as important in a question which requires extracts from a statement of cash flows as it is for a complete statement of cash flows. Marks were also lost where items were shown under the incorrect headings – the most common error being to show dividends paid to the non-controlling interest as an investing activity instead of as a financing activity, and this was often also shown as a cash inflow instead of as an outflow. Some also prepared the T account workings correctly but then failed to transfer the final figure to the face of the statement of cash flows.

Where errors were made they included the following:

- Omitting one or more of the entries from the property, plant and equipment T-account, most commonly the revaluation figure.
- Failing to adjust for the transfer between the revaluation surplus and retained earnings in the latter T-account.
- Omitting the statement of profit or loss figure from the retained earnings and/or non-controlling interest T-accounts.
- Debiting the whole bonus issue to the share premium account, when this should have been restricted to the opening balance on the share premium account, which was lower.
- Omitting the residual bonus issue from the retained earnings T-account.
- Failing to adjust the non-controlling interest figure for the disposal of the subsidiary.

Total possible marks	11
Maximum full marks	11

Question 3

Overall marks for this question can be analysed as follows: **Total: 28**

General comments
Part (a) of this question required candidates to explain the financial reporting treatment of four accounting issues, given in the scenario. The four issues covered a government grant, an acquisition of a subsidiary, an asset impairment and a related party transaction.
Part (b) required candidates to recalculate consolidated profit for the year for the adjustments needed as a result of their answer to Part (a).
Part (c) required a calculation of basic earnings per share following a share issue for cash and a bonus issue.
Part (d) required candidates to identify any UK GAAP differences for the issues set out in Part a).

Melloch plc
(a) IFRS accounting treatment

(1) Government grant

This is an income related grant and in this case it should be recognised over the two year period to match the expenditure for which it has been received to compensate. Even though the directors believe that the grant will not be repayable this is not a reason to recognise it fully upon receipt. As at 30 September 2013 Melloch plc has not satisfied all of the recognition criteria.

£225,000 (£540,000 x 10/24) of the grant should be recognised as income in the current period. The remaining grant of £315,000 (£540,000 – £225,000) should be removed from profit or loss and recognised as a liability.

The liability should be split between current £270,000 (540,000 x 12/24) and non-current £45,000 (£315,000 – £270,000).

The grant should not be recognised as revenue. It could either be shown as "other income" in the statement of profit or loss or it could be netted off against the expenditure to which it relates (probably as part of "operating costs").

(2) Acquisition of Sheardale Ltd

Sheardale Ltd should be recognised as a subsidiary of Melloch plc at 1 April 2013, as a controlling interest of 80% has been acquired. Sheardale Ltd should be consolidated in the group financial statements from this date.

The consideration should be measured at its fair value of £480,000.

The costs of £8,000 should not form part of the consideration but should instead be recognised directly in profit or loss.

Intangible assets should be recognised if they are separable or they arise from legal or other contractual rights. These contractual rights should therefore have been recognised and form part of Sheardale Ltd's net assets.

The contractual rights should be recognised separately to the goodwill and amortised over their useful life of three years. The carrying amount of the contractual rights at 30 September 2013 is therefore £62,500 (£75,000 – £12,500) and £12,500 ((£75,000/3yrs) x 6/12) should be recognised in profit or loss as amortisation. As the intangible asset is held by Sheardale Ltd, the amortisation will affect the profit attributable to the non-controlling interest. It will therefore be split £10,000 and £2,500 between the profit attributable to the shareholders of Melloch plc and the non-controlling interest respectively.

The non-controlling interest can be measured at fair value or proportion of net assets at the date of acquisition, however here the proportionate method should be used.

Goodwill should be measured at:

	£
Fair value of consideration	480,000
Non-controlling interest – (650,000 x 20%)	130,000
	610,000
Net assets acquired (575,000 + 75,000)	(650,000)
Goodwill – gain on bargain purchase	(40,000)

As a gain on bargain purchase has arisen Melloch plc will need to reassess the identification and measurement of the net assets and the measurement of the consideration, however in this case this is purely cash paid at the date of acquisition. Assuming these calculations are correct the gain of bargain purchase should be recognised as part of profit or loss for the period.

Sheardale Ltd's loss attributable to Melloch plc's shareholders since acquisition should be recognised in the consolidated statement of profit or loss at £72,000 (£180,000 x 6/12 x 80%) and the non-controlling interest in the statement of profit or loss should be decreased by £18,000 (£90,000 x 20%).

Consolidated net assets at 30 September 2013 will also decrease.

(3) Impairment of research facility

It appears that the research facility has suffered an impairment and therefore its carrying amount may be overstated. Assets should not be carried at more than their recoverable amount. Recoverable amount is the higher of value in use and fair value less costs to sell.

The value in use at 30 September 2013 is £1,100,000 and fair value less costs to sell is £1, 245,000 (£1,250,000 – £5,000). The recoverable amount is therefore £1,245,000 and an impairment of £155,000 (£1,400,000 – £1,245,000) should be recognised.

£100,000 should therefore be recognised against the balance of the revaluation surplus, to reduce this amount to zero. The remaining £55,000 should be recognised as part of profit and loss for the period.

(4) Related party

Melloch plc will need to establish whether or not the sale of the vehicle to the marketing director is a related party transaction under IAS 24 Related Party Disclosure.

The marketing director is a member of the key management personnel of Melloch plc and therefore he is a related party under IAS 24. Therefore, the sale of the vehicle to the marketing director is a related party transaction. Even though the sale was at full fair value, it should be disclosed.

Disclosure should include the nature of the related party relationship, ie one of the directors, and whether there are any outstanding balances at the year end, ie £17,500. If there are any special terms and conditions attached to the balance this should also be disclosed.

A statement that the transaction took place on an arm's length basis could only be made if it can be substantiated. Presumably here an external vehicle guide would show the fair value of the vehicle and assuming it to be in line with the price agreed such a statement could be made.

Answers to this part of the question were good. Most candidates correctly identified three out of the four underlying issues as a revenue grant, the acquisition of a subsidiary and the impairment of an item of property, plant and equipment. The related party transaction was less well dealt with, a significant number of candidates completely missing that this was a related party transaction at all.

Some marks (though not many) were lost on errors in the calculations but more were lost where candidates, after an initial explanation, then reduced their answer to a series of journal entries. Although there were specific marks allocated to key calculations and to the adjustments using those figures in Part (b), there were no marks for journal entries in lieu of narrative explanations. Marks are only ever awarded for journal entries where these are specifically required by the question.

(1) Government grant

Most candidates correctly described the conditions under which a grant can be fully recognised as revenue but then went on to correctly describe how the income should be deferred. The majority of candidates correctly calculated the amount which could be recognised in income in the current year (with only a minority using the wrong number of months) and correctly split the balance between non-current and current liabilities.

(2) Acquisition of subsidiary

Almost all candidates correctly recognised this as the acquisition of a subsidiary and that it should therefore be consolidated. Candidates then correctly went on to calculate goodwill, although not all arrived at a gain on bargain purchase (in which case marks were given for describing the correct accounting treatment of goodwill, both in this part and in Part (d)). The most common two errors in this calculation were including the associated costs of acquisition in the fair value of the consideration and/or failing to increase the net assets figure by the fair value of the contractual rights.

A good number of candidates then arrived at the correct amortisation charge for the year on these rights, but less went on to split this charge between the parent and the non-controlling interest. Similarly, most recognised that the subsidiary's loss for the year should be recognised in the consolidated statement of profit or loss, a few less correctly stated that only six-twelfths of this figure should be recognised, with fewer still splitting the resultant figure between the parent and the non-controlling interest.

It was rare for candidates to make the point that the non-controlling interest could be measured using the fair value method or the proportionate method, and that the latter was the chosen method. Only a very small minority of candidates made the point, where a gain on bargain purchase had been calculated, that this should be reassessed. A significant number of candidates stated that the gain on bargain purchase should be immediately recognised in retained earnings, rather than making it clear that it should be immediately recognised in the consolidated statement of profit or loss.

(3) Impairment of research facility

There were some very good answers to this part. Almost all candidates correctly stated the "rules" for calculating the amount of an impairment and calculated the correct figures, setting the impairment firstly against the revaluation surplus for this asset. The most common error was to calculate the impairment as the difference between the carrying amount and the value in use, instead of the fair value less costs to sell (which was higher). A significant minority of candidates discussed the scenario as one of an asset held for sale (and then possibly dealt with the legal costs separately).

(4) Related party transaction

Answers to this issue were very disappointing with very many candidates not even recognising that the key issue here was the disclosure of a related party transaction. Of those who did identify that it was a related party transaction only a few explained why the director was considered to be a related party and what details needed to be disclosed. Fewer still made the point that, provided that fact could be substantiated, the arm's length nature of the transaction could be disclosed.

Frighteningly a very significant number of candidates appeared to believe that transactions should not be recognised until the cash had been received and therefore felt that the sale needed to be derecognised, so it was very common to see an adjustment for the profit on sale of £2,500 in Part (b).

Total possible marks	26
Maximum full marks	17

(b)

Melloch plc

Profit attributable to Melloch plc's shareholders

	£
As stated	978,400
(1) Government grant	(315,000)
(2) Acquisition of Sheardale Ltd:	
- acquisition costs	(8,000)
- intangible amortisation	(10,000)
- gain on bargain purchase	40,000
- Share of Sheardale Ltd's loss	(72,000)
(3) Impairment	(55,000)
Restated	558,400

It appeared that most candidates had built up their answer to this part alongside their answers to Part (a), which is by far the most efficient approach, with most candidates including all of the relevant adjustments that they had discussed in Part (a). The most common errors were to include the gain on bargain purchase as an expense and the (share) of the subsidiary's loss as a profit or not at all.

Total possible marks	3
Maximum full marks	3

(c)

Melloch plc

	No. Of shares	Period in issue	Bonus factor	Weighted average
1 Oct – 30 Nov	280,000	2/12	6/5	56,000
1 Dec – issue at MV	70,000			
1 Dec – 31 Mar	350,000	4/12	6/5	140,000
Bonus issue – 1 April (350,000 / 5)	70,000			
1 Apr – 30 Sept	420,000	6/12	–	210,000
				406,000

Basic EPS = $\frac{558,400}{406,000}$ = £1.38

Many candidates scored full marks on this part. Those that made a poor attempt at this calculation clearly did not understand the impact of the bonus issue. Where errors were made they included the following:

- Using the wrong fractions for the parts of the year, or for the bonus issue, or both.
- Applying those fractions the 70,000 increments, instead of to the cumulative number of shares to date.

Total possible marks	4
Maximum full marks	3

(d) UK GAAP differences

Acquisition of subsidiary
The contractual rights are treated differently under UK GAAP as they would not be recognised as these are not separable. Hence the intangible asset would be subsumed as part of the goodwill, rather than separately recognised as per IFRS.

The £8,000 acquisition costs associated with the acquisition would be recognised as part of the consideration rather than expensed to profit and loss as per IFRS.

There is no option to use fair value to measure the non-controlling interest as per IFRS, instead it would be measured as a proportion of net assets.

Negative goodwill (a gain or bargain purchase) is recognised as a separate item within goodwill rather than recognised in profit or loss for the period as per IFRS. The negative goodwill should be split between the fair value of the non-monetary assets and that which is in excess of the fair value of these assets. This determines the period over which the negative goodwill should be recognised in profit and loss.

Impairment
Under UK GAAP an impairment on a revalued asset would normally be recognised against the balance on the revaluation surplus unless the impairment was as a result of a consumption of economic benefits. It is unlikely that the impairment of the research facility is a result of a consumption of economic benefits and therefore there would be no difference in treatment. Under IFRS there is no such requirement.

Related parties
Under UK GAAP FRS 8 requires the consideration of materiality to both sides of a related party transaction. IFRS requires no such consideration of materiality.

Under FRS 8, the names of the related parties would need to be disclosed, there is no such requirement under IFRS.

Most candidates adopted the columnar approach recommended by the examining team at the recent tutor conference, giving both the IFRS and the UK GAAP treatments and giving only differences which were relevant to the issues in Part (a). It was also clear that more candidates had committed these differences to memory. Those who had learnt these differences scored well easily picking up three or more of the available five marks.

The most common mistake was to state that under UK GAAP impairments can never be taken to the revaluation surplus.

Total possible marks	8½
Maximum full marks	5

Question 4

Overall marks for this question can be analysed as follows: **Total: 14**

General comments
This question was a mixed topic question, covering inventory valuation and a sale and operating leaseback.
Part b) required a discussion around the ethical issues.

Bainsford plc

(i)
Statement of financial position at 30 September 2013 (extract)

Current assets (275,850 + 9,600(W1) – 3,000(W2))	282,450
Current liabilities (141,700 + 93,750 (W3))	235,450

(ii)
Statement of profit or loss

	£
Draft profit after tax	497,300
Increase in raw materials	9,600
Decrease in finished goods	(3,000)
Sale and leaseback adjustment ((375,000 – 93,750) – 250,000)	31,250
Impairment loss	(125,000)
	410,150

Workings

(1) Raw materials

	£
Weighted average	
$\frac{(5{,}000 \times £74) + (6{,}000 \times £65) + (4{,}000 \times £80)}{(5{,}000 + 6{,}000 + 4{,}000))} \times 1{,}200$	(86,400)
FIFO £80 x 1,200	96,000
	9,600

(2) Finished goods

	£
Absorption rate (1.50 – 0.25 – 0.15) = £1.10	
Adjustment	
(£1.50 – £1.10) x 7,500	3,000

(3) Sale and operating leaseback

	£
Carrying amount	900,000
Less: fair value	(775,000)
Impairment loss	125,000
Proceeds	1,150,000
Less: fair value	(775,000)
Profit	375,000
Deferred income (375,000 x 3/12)	93,750

Answers to this were quite mixed although most candidates calculated, as required, the three revised figures, and, on the whole, carefully followed their supporting calculations through to these figures. A good number arrived at the correct adjustment to both raw materials and finished goods, although typically whilst the adjustment relating to the raw materials was calculated correctly far fewer candidates could correctly identify which costs should be included in the value of finished goods. The most common errors were mistakes in calculating the weighted average cost of raw materials and failing to exclude the storage costs when calculating the absorption rate for finished goods.

Attempts at adjusting for the sale and operating leaseback were very mixed, with many candidates writing at length about the appropriate accounting treatment, when only the calculations were required (no use of the word "explain" in the requirement). Although most candidates who made a reasonable attempt at these calculations did realise that the profit on disposal should be recognised over the lease term rather than recognised immediately few calculated it correctly by failing to account for the impairment first. Often the same figure was used to adjust liabilities and profit rather than recognising that the deferred amount should be added to liabilities and the proportion recognised up until the year-end added to profit.

Total possible marks Maximum full marks	10½ 9

(b)

Nia's concerns about the use of creative accounting may be justified as after the adjustments she made to the draft consolidated profit for the year, profit has fallen by 17.5%. While some of the adjustments may be attributable to Nia's assistant's lack of knowledge of accounting standards, the fact that the finance director was on hand to help may call into question the finance directors behaviour and whether the figures have been deliberately inflated.

Nia should make the appropriate adjustments to the financial statements and explain to the finance director why profit has fallen. If her adjustments are challenged, she may need to seek advice on how to proceed. In the first instance Nia should speak to the other directors or the audit committee. Much will depend upon the finance director's attitude and whether Nia is challenged in her adjustments. If Nia is still concerned about the issues not being dealt with correctly she may wish to contact the ICAEW advisory helpline.

Nia's other ethical problem relates, in part, to confidentiality. Confidentiality is one of the five fundamental principles set out in the ICAEW's ethical Code. Nia is expressly required to respect the confidentiality of information required as a result of professional and business relationships. The information about the competitor, of which she is now aware because of a personal contact, could possibly be of benefit to Bainsford plc, and so Nia might be tempted to discuss this information with her employer as it may impact on their business and the opportunity to gain additional funding. Passing on such information may balance out any ill-feelings as a result of making the adjustments to reduce profit and would show her loyalty to her employer. However, professional accountants should be guided not only by the terms but also by the spirit of the ethical Code. Taking this approach, confidentiality should be maintained.

Another of the five fundamental principles is professional behaviour. Professional accountants should avoid any action that discredits the profession. If Nia were to use the information for the benefit of her employers, and if this were subsequently to be made public, it is likely that this would appear discreditable to the profession.

As in previous sittings, many candidates framed their answer as if they were part of an audit team, not employed within industry. It was therefore inappropriate to suggest referring the matter to the ethics partner or to discuss approaching the audit with increased professional scepticism. With regard to the information from Sam, most candidates recognised the need to refer to the fundamental principle of confidentiality and knew that Nia should not repeat this information. Others thought that she should repeat it if it could be substantiated. Few referred to the fundamental principle of professional behaviour, which was also relevant. Almost all candidates did recognise the possible need to contact the ICAEW confidential helpline if they were unable to resolve the issues via discussion with the finance director, or with the other directors or the audit committee, but there was a tendency to be very quick to suggest that their own resignation might be the best solution.	
Total possible marks	9
Maximum full marks	5

Question 5

Overall marks for this question can be analysed as follows: **Total: 17**

General comments
This question required the preparation of a consolidated statement of profit or loss and extracts from the consolidated statement of changes in equity (for retained earnings and the non-controlling interest). The group had two subsidiaries, one of which was acquired during the year and a joint venture. Fair value adjustments were required on acquisition of one of the companies. Inter-company trading took place during the year between one of the subsidiary's and the parent and the other subsidiary.

Cambus plc

(i) Consolidated statement of profit or loss for the year ended 30 September 2013

	£
Revenue (W1)	2,017,550
Cost of sales (W1)	(677,050)
Gross profit	1,340,500
Operating expenses (W1)	(504,700)
Profit from operations (W1)	835,800
Share of profit of jointly controlled entity (W4)	12,850
Profit before tax	848,650
Income tax expense (W1)	(178,650)
Profit for the period	670,000
Profit attributable to	
Owners of Cambus plc (β)	613,050
Non-controlling interest (W2)	56,950
	670,000

(ii) Consolidated statement of changes in equity for the year ended 30 September 2013 (extract)

	Retained earnings £	Non-controlling interest £
Balance at 1 October 2012 (W6 & W5)	266,515	215,180
Total comprehensive income for the year	613,050	56,950
Added on acquisition of subsidiary (82,500 + 280,000) x 20%	–	72,500
Dividends (500,000 x 50p) / (300,000 x 25p x 35%)	(250,000)	(26,250)
Balance at 30 September 2013 (β)	629,565	318,380

Workings

(1) Consolidation schedule

	Cambus plc	Ochill Ltd	Kennet Ltd (6/12)	Adj	Consol
	£	£	£	£	£
Revenue	1,285,300	579,000	216,250	(63,000)	2,017,550
Cost of sales – per Q	(418,200)	(236,200)	(82,650)	63,000	(677,050)
– PURP (W7)		(3,000)			
Op expenses – per Q	(267,500)	(172,000)	(61,200)		(504,700)
– FV deprec (100,000/25yrs)		(4,000)			
Investment income	48,750				
– Ochill (300,000 x 65% x 25p)				(48,750)	–
Tax	(130,000)	(34,200)	(14,450)		(178,650)
		129,600	57,950		

(2) Non-controlling interest in year

	£
Ochill Ltd (35% x 129,600 (W1))	45,360
Kennet Ltd (20% x 57,950 (W1))	11,590
	56,950

(3) Ochill Ltd – Net assets

	(Proof only) 30 Sept 2013	1 Oct 2012	At acquisition
	£	£	£
Share capital	300,000	300,000	300,000
Retained earnings (W)	296,400	234,800	153,700
PURP adj (W6)	(3,000)		
FV adjustment	100,000	100,000	100,000
FV – depreciation (4,000 x 6 / 5yrs)	(24,000)	(20,000)	–
Total	669,400	614,800	553,700

W (296,400 – 136,600 + (300,000 x 25p) = 234,800

(4) Jointly controlled entity – Izat Ltd

	£
Share of profit for the year (44,625 x 40%)	17,850
Less: Impairment	(5,000)
	12,850

(5) Non-controlling interest brought forward – Ochill Ltd

	£
At acquisition (553,700 (W3) x 35%)	193,795
Share of post-acquisition profits ((614,800 – 553,700) x 35%)	21,385
	215,180

(6) Retained earnings brought forward

	£
Cambus plc (461,200 – 518,350)	(57,150)
Add back dividend (500,000 x 50p)	250,000
Izat Ltd – post acquisition ((225,500 – 44,625 – 96,000) x 40%)	33,950
Ochill Ltd – post acquisition ((614,800 – 553,700) x 65%) (W3)	39,715
	266,515

(7) PURP

	%	£
SP	120	36,000
Cost	(100)	(30,000)
GP	20	6,000
X $^1/_2$		3,000

(8) Non-controlling interest carried forward (for proof only)

Ochil Ltd		
At acquisition ((300,000 + 153,700 + 100,000) x 35%)	193,795	
Share of post-acquisition profits ((669,400 – 553,700) x 35%)	40,495	
		234,290
Kennet Ltd		
At acquisition ((280,000 + 82,500) x 20%)	72,500	
Share of post-acquisition profits ((140,450 – 82,500) x 20%)	11,590	
		84,090
		318,380

(9) Retained earnings carried forward (for proof only)

	£
Cambus plc	461,200
Izat Ltd – post acquisition (225,500 – 96,000) x 40%	51,800
Less: impairment – Izat Ltd	(5,000)
Ochill Ltd - post acquisition ((669,400 – 553,700) x 65%) (W3)	75,205
Kennet Ltd – post acquisition (140,450 – 82,500) x 80%) (W4)	46,360
	629,565

Most candidates produced a well laid out consolidated statement of profit or loss, and showed the split between the profit attributable to the parent and to the non-controlling interest. This was backed up, on the whole, by a well laid out consolidation schedule. Attempts at the consolidated statement of changes in equity were generally less good, both in presentation and in content.

Many candidates produced a completely correct consolidation schedule, with figures for the provision for unrealised profit and the additional depreciation, in the appropriate columns. The vast majority of candidates correctly took only six-twelfths of the subsidiary's figures to their consolidation schedule. The most common omission was not to calculate the parent's share of the dividend from the subsidiary held throughout the year and realise that it made up the whole of the parent's investment income and that therefore the two figures should be cancelled out. Other common errors were to include a provision for unrealised profit even where the goods had been sold on to third parties and adjusting the parent's costs (rather than the subsidiary's) for the additional depreciation arising from the fair value adjustment.

The figure for share of profit of jointly controlled entity was more often than not correctly calculated, with the most common error being to omit the impairment. A minority of candidates attempted to calculate some sort of statement of financial position figure, which they then reduced by the impairment or describe the figure as "share of associate" on the face of the consolidated statement of profit or loss.

Unfortunately answers to the second part of the question relating to the consolidated statement of changes in equity extract were far weaker. Although most candidates did enter the relevant figures from the consolidated statement of profit or loss many went no further than this. A significant number of candidates correctly calculated the dividend paid by the subsidiary acquired during the year to the non-controlling interest, with the figure omitted more often than errors were made.

A figure for the non-controlling interest added on acquisition of the subsidiary was not seen very often, but where it was included it was more often than not the correct figure. Only some candidates made some attempt to calculate either non-controlling interest and retained earnings brought forward or carried forward and earned some marks for this, but these figures were rarely completely correct, although candidates did pick up some marks, most commonly for an attempt at a net assets table which they used to arrive at post acquisition earnings.

No marks were given for a group structure diagram, since the percentage holdings were given in the question, although many candidates did produce such a diagram. Some candidates were, however, careless in their use of these percentages, the most common error being to use the parent's percentages in calculating the non-controlling interest.

Total possible marks	19½
Maximum full marks	17

PROFESSIONAL LEVEL EXAMINATION

MONDAY 16 MARCH 2015

(3 hours)

FINANCIAL ACCOUNTING AND REPORTING

This paper consists of **FOUR** questions (100 marks).

1. Ensure your candidate details are on the front of your answer booklet. You will be given time to sign, date and print your name on the answer booklet, and to enter your candidate number on this question paper. You may not write anything else until the exam starts.

2. Answer each question in black ballpoint pen only.

3. Answers to each question must begin on a new page and must be clearly numbered. Use both sides of the paper in your answer booklet.

4. The examiner will take account of the way in which answers are presented.

5. When the assessment is declared closed, you must stop writing immediately. If you continue to write (even completing your candidate details on a continuation booklet), it will be classed as misconduct

Unless otherwise stated, make all calculations to the nearest month and the nearest £.

All references to IFRS are to International Financial Reporting Standards and International Accounting Standards.

IMPORTANT Question papers contain confidential information and must NOT be removed from the examination hall. **DO NOT TURN OVER UNTIL YOU ARE INSTRUCTED TO BEGIN WORK**	You MUST enter your candidate number in this box. |				

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1. You are the financial controller at Coghlan Ltd and an ICAEW Chartered Accountant. You are finalising the financial statements for the year ended 30 September 2014. Your colleague, a part-qualified ICAEW Chartered Accountant, has produced the following draft financial statements with some additional information. He was assisted by the managing director's son, who was on work experience at Coghlan Ltd.

You are under pressure from the managing director to finalise the financial statements as quickly as possible as he is about to go on holiday. The managing director has reminded you that your performance appraisal is due and has hinted that if you finalise the financial statements quickly he will make sure this is reflected in your appraisal which is linked to your salary.

Draft statement of profit or loss for the year ended 30 September 2014

	£
Revenue (Note 1)	3,359,200
Cost of sales	(2,198,050)
Gross profit	1,161,150
Administrative expenses (Note 2)	(1,039,700)
Operating profit	121,450
Other costs (Note 3)	(500,000)
Finance costs (Note 4)	(38,000)
Loss before tax	(416,550)
Income tax (Note 5)	–
Loss for the year	(416,550)

Draft statement of financial position as at 30 September 2014

	£	£
ASSETS		
Non-current assets		
Property, plant and equipment (Note 6)		1,110,325
Current assets		
Inventories (Note 7)	142,100	
Trade and other receivables	125,400	
Cash and cash equivalents	1,200	
		268,700
Total assets		**1,379,025**
EQUITY AND LIABILITIES		
Equity		
Ordinary share capital (£1 shares) (Note 4)		294,500
Share premium		94,000
Retained earnings		425,825
		814,325
Current liabilities		
Trade and other payables	31,900	
Provision (Note 3)	500,000	
Income tax (Note 5)	32,800	
		564,700
Total equity and liabilities		**1,379,025**

Additional information:

(1) Coghlan Ltd has launched a new monthly technical magazine to its customers on a subscription basis, based on a calendar year. £36,000 was received in annual subscriptions in December 2013 for the year commencing 1 January 2014. This was recognised immediately as revenue as the amount could be measured reliably and the economic benefit had flowed to Coghlan Ltd.

(2) On 1 October 2013 Coghlan Ltd entered into a new six-year lease for a regional office. Lease payments are £1,200 per month payable at the beginning of each month. The building is estimated to have a useful life of 30 years. Coghlan Ltd negotiated a rent holiday for the first six months. As a consequence, the rent for the final six months of the lease will be double. The first payment of £1,200 was made on 1 April 2014. The lease payments were recognised in administrative expenses as they were paid.

(3) The provision of £500,000 shown in the financial statements above relates to outstanding lawsuits for the supply, prior to the year end, of faulty products by Coghlan Ltd to a number of customers. This amount has been recognised as a provision based on advice from Coghlan Ltd's lawyers that the claims are very likely to succeed within the next six months, which has led to some adverse publicity. The product was withdrawn in August 2014.

Since recognising the above provision, Coghlan Ltd discovered that there are an additional 50 faulty products still in circulation. Coghlan Ltd's lawyers estimated for each product £350 would need to be paid.

During the year Coghlan Ltd started offering a one-year repair warranty with its luxury products. If minor repairs were required for all the relevant goods sold the cost would be £65,000, compared to £157,000 if major repairs were required. Coghlan Ltd estimates that 20% of the goods sold will require minor repairs and 5% will require major repairs. No provision was recognised in respect of the warranties for the year ended 30 September 2014 as no goods had been returned by this date.

(4) An interim ordinary dividend of 10p per share was paid on 11 May 2014 and recognised as a finance cost. Shortly after this, Coghlan Ltd entered into a share buyback scheme to reacquire 45,000 £1 ordinary shares for £1.90 cash per share. The total cash paid was debited to share capital.

(5) The income tax figure shown in the statement of financial position is the balance remaining on the nominal ledger after paying the liability for the previous year. As a loss was made for the year ended 30 September 2014 a tax refund of £65,000 has been appropriately estimated but has not yet been recognised.

(6) Depreciation on property, plant and equipment for the year ended 30 September 2014 has not yet been charged. The following information is available:

	Land and buildings	Fixtures and fittings
Cost (land £250,000)	£1,125,000	£236,000
Accumulated depreciation at 1 October 2013	£187,500	£63,175
Depreciation rate and method (buildings)	5% pa straight-line	20% pa reducing balance
Recoverable amount (land £225,000) at 30 September 2014	£600,000	£170,000

Land and buildings consist of Coghlan Ltd's head office and main warehouse which are located together on one piece of land. Local market values decreased following an announcement that a wind farm is to be built in the area.

All expenses in respect of property, plant and equipment should be recognised in administrative expenses.

(7) Inventories at 30 September 2013 and 2014 were valued at net realisable value, as this was higher than cost. The following inventory valuations are relevant.

	30 September 2014	30 September 2013
	£	£
Cost	98,000	79,000
Net realisable value	142,100	114,550

Requirements

(a) Prepare a revised statement of profit or loss for Coghlan Ltd for the year ended 30 September 2014 and a revised statement of financial position as at that date, in a form suitable for publication. Notes to the financial statements are **not** required.
(19 marks)

(b) IAS 1, Presentation of Financial Statements, requires financial statements to be prepared using the accruals basis of accounting and the IASB's Conceptual Framework refers to going concern as the underlying assumption in the preparation of financial statements. Explain these two concepts, illustrating their application with reference to Coghlan Ltd.
(6 marks)

(c) Discuss the ethical issues arising from the scenario for you as financial controller and the steps that you should take to address them.
(5 marks)

Total: 30 marks

2. The draft financial statements of Porcaro plc, which has a number of wholly-owned subsidiaries, are being prepared by your trainee, Carmine. A number of outstanding issues are set out below which require your attention, as financial controller, as Carmine was unsure of the correct accounting treatment.

The draft consolidated profit for the year ended 30 September 2014 is £483,150.

(1) On 1 October 2013 Porcaro plc borrowed £600,000 at 6% pa, repayable in three years' time, to help fund the construction of an office block. Porcaro plc immediately paid £200,000 to acquire land and gained planning permission on this date but construction did not start until 31 December 2013. The remaining amount was put into a deposit account earning interest at 3% pa and was used to make payments to the construction company of £100,000 on 1 March 2014 and £200,000 on 1 September 2014. The building was not complete at the year end and a further payment of £100,000 was due to the construction company after 30 September 2014. All relevant interest was received and paid on 30 September 2014.

Carmine recognised the net interest paid in the statement of profit or loss and capitalised all other costs incurred as an asset in the course of construction.

(2) On 1 October 2013 Porcaro plc issued 6,000 5% £100 convertible bonds. Each bond is redeemable in four years' time at par or can be converted into 100 £1 ordinary shares. Interest is payable annually in arrears and the market rate of interest for similar bonds without the conversion option is 7% pa. Carmine has credited the cash proceeds from the bond issue to non-current liabilities. The annual interest of £30,000 was paid at the year end and was recognised as a finance cost.

(3) On 1 April 2014 Porcaro plc paid £72,000 for a licence for the production of a state of the art microchip. At the end of six years it is thought that the licence will be worthless due to advances in technology. Carmine has recognised the licence in the draft financial statements as an intangible asset of £90,000 as this is the amount that a competitor offered to Porcaro plc for the licence on 30 June 2014 due to its unique nature. Carmine showed the increase in value as a revaluation surplus in equity.

(4) On 1 May 2014 Porcaro plc and three other unrelated trading companies each purchased one quarter of the 100,000 £1 ordinary shares, at par, of a newly incorporated company, Barbarossa Ltd. Under a contractual agreement each investor is entitled to an equal share of the profits and losses and unanimous consent is required for all key operating decisions. For the period ended 30 September 2014 Barbarossa Ltd reported a profit after tax of £130,000, no dividends have yet been paid. On acquisition, Carmine recognised the cost of the 25,000 shares in Barbarossa Ltd as a current asset. No other accounting entries have been made in respect of Barbarossa Ltd.

On 1 October 2013 Porcaro plc had in issue 270,000 £1 ordinary shares. On 1 February 2014 Porcaro plc made a 1 for 3 rights issue for £1.70 per share. The market price of one Porcaro plc ordinary share immediately before the rights issue was £2.10.

Requirements

(a) Explain the required IFRS financial reporting treatment of the four issues above in the financial statements for the year ended 30 September 2014, preparing all relevant calculations and setting out the required adjustments in the form of journal entries. **(27 marks)**

(b) Using your results from Part (a) calculate a revised figure for consolidated profit for the year. **(2 marks)**

(c) (i) Calculate basic earnings per share for the Porcaro plc group.

(ii) Briefly explain the treatment of the rights issue in the above calculation. **(6 marks)**

(d) Describe the difference between IFRS and UK GAAP in relation to issue (1) above. **(1 mark)**

Total: 36 marks

3. Henrit plc has two subsidiary companies, one of which was acquired during the year ended 30 September 2014. Set out below is an extract from all three companies' draft statements of financial position.

Draft statements of financial position at 30 September 2014 (extracts)

	Henrit plc (single company)	Bonham Ltd	Crago Ltd
ASSETS	£	£	£
Non-current assets			
Property, plant and equipment	963,200	469,400	623,150
Investments	475,000	–	–
Current assets			
Inventories	46,980	18,900	31,300

Additional information:

(1) At 1 October 2013 Henrit plc held property, plant and equipment with a carrying amount of £729,400, none of which had been acquired under finance leases. During the year ended 30 September 2014 Henrit plc sold equipment with a carrying amount of £124,000, recognising a profit on disposal of £9,500. Depreciation of £113,000 was recognised.

Henrit plc acquired new plant during the year; some additions were made under a finance lease with the remainder for cash. The draft financial statements show a total finance lease liability of £97,725 at 30 September 2014 and a lease payment of £15,000 was made during the year.

(2) The statement of profit or loss shows finance costs of £25,875 which relate to the interest due on a bank loan and interest on the finance lease. Interest at 5% pa is payable on the bank loan. At 1 October 2013 Henrit plc had a bank loan of £290,000, with additional funding of £160,000 obtained on 1 April 2014.

(3) At 1 October 2013 Henrit plc had an investment in a wholly owned subsidiary, Bonham Ltd. This investment cost £200,000 and gave rise to goodwill at acquisition of £73,400.

On 1 April 2014 Henrit plc acquired 60% of the ordinary share capital of Crago Ltd for consideration comprising cash of £230,000 and 45,000 £1 ordinary shares in Henrit plc, with a market value of £3.15 each. The investment in Crago Ltd was recognised in non-current assets at £275,000 being the cash consideration and the share issue at £1 nominal value. The fair value of the assets and liabilities acquired were £615,000 at the date of acquisition which was the same as their carrying amount. The non-controlling interest and goodwill on the acquisition of Crago Ltd were calculated using the fair value method. The fair value of the non-controlling interest at 1 April 2014 was £261,000.

(4) Immediately after its acquisition by Henrit plc, Crago Ltd sold a machine to Henrit plc for £53,000. The machine had originally been acquired by Crago Ltd for £95,000 on 1 October 2011 and had an estimated five year useful life, which has never changed.

(5) In August 2014 Bonham Ltd sold goods to Crago Ltd for £11,500 at a mark-up of 15%. All of these goods were still in Crago Ltd's inventories at the year end.

Requirements

(a) Using the draft financial statements for Henrit plc and the additional information set out in (1) and (2) above, prepare extracts from Henrit plc's single company statement of cash flows for the year ended 30 September 2014 showing figures under the headings:

(i) Cash flows from investing activities

(ii) Cash flows from financing activities **(6 marks)**

(b) Using the draft financial statements of all three companies and the additional information set out in (3) to (5) above prepare extracts from the consolidated statement of financial position of Henrit plc as at 30 September 2014 showing:

(i) Non-current assets

(ii) Current assets **(5 marks)**

Total: 11 marks

PLEASE TURN OVER

4. At 1 October 2013 Mantia plc had investments in two companies: an 80% holding in Appice Ltd and a 65% holding in Starkey Ltd.

On 1 April 2014 Mantia plc sold all of its 91,000 £1 ordinary shares in Starkey Ltd, for £427,000. The disposal proceeds were credited to a suspense account. Starkey Ltd's retained earnings at 1 October 2013 were £243,000. Mantia plc measures all non-controlling interest and goodwill on acquisition using the proportionate method.

The draft individual statements of profit or loss of the three companies are shown below:

Draft statements of profit or loss for the year ended 30 September 2014

	Mantia plc	**Appice Ltd**	**Starkey Ltd**
	£	**£**	**£**
Revenue	2,986,000	768,000	1,672,000
Cost of sales	(1,343,700)	(345,600)	(585,200)
Gross profit	1,642,300	422,400	1,086,800
Operating expenses	(419,575)	(84,480)	(334,100)
Profit from operations	1,222,725	337,920	752,700
Investment income	42,600	–	–
Profit before tax	1,265,325	337,920	752,700
Income tax expense	(259,000)	(68,000)	(152,500)
Profit for the year	1,006,325	269,920	600,200

The draft individual statements of financial position at 30 September 2014 for Mantia plc and Appice Ltd show:

	Mantia plc	**Appice Ltd**
	£	**£**
Equity		
Ordinary share capital (£1)	500,000	80,000
Retained earnings	596,300	384,200

Additional information:

(1) Mantia plc acquired its holding in Appice Ltd on 1 October 2012 when Appice Ltd's retained earnings were £136,000. The fair values of all Appice Ltd's assets and liabilities at the date of acquisition were the same as their carrying amounts, with the exception of a machine which was estimated to have a fair value of £70,000 in excess of its carrying amount. The machine was assessed as having a remaining useful life of ten years at 1 October 2012. Depreciation of plant and machinery is recognised in operating expenses.

(2) Mantia plc acquired its holding in Starkey Ltd several years ago for £230,000 when Starkey Ltd's retained earnings were £162,000. The fair values of all Starkey Ltd's assets and liabilities at the date of acquisition were the same as their carrying amounts. Starkey Ltd's revenue and costs accrued evenly over the current year.

(3) During the year Appice Ltd sold goods to Mantia plc for £32,000 earning a gross margin of 15%. At the year-end Mantia plc still held a quarter of these goods.

(4) Mantia plc and Appice Ltd paid a dividend of £1.20 and 40p per share respectively during the year ended 30 September 2014.

(5) Mantia plc has undertaken its annual impairment review of goodwill and identified that an impairment of £25,000 has arisen in relation to Appice Ltd and should be recognised. No impairment of goodwill arose in the year in respect of the acquisition of Starkey Ltd, however, cumulative impairments of £18,000 had been recognised at 1 October 2013.

Requirements

(a) Prepare, for Mantia plc for the year ended 30 September 2014:

(i) a consolidated statement of profit or loss;

(ii) the retained earnings column from the consolidated statement of changes in equity.

You should assume that the disposal of Starkey Ltd constitutes a discontinued activity in accordance with IFRS 5, Non-current Assets Held for Sale and Discontinued Operations. **(20 marks)**

(b) Describe the differences between IFRS and UK GAAP in relation to the acquisition and disposal of Starkey Ltd. **(3 marks)**

Total: 23 marks

PROFESSIONAL LEVEL EXAMINATION

MONDAY 8 SEPTEMBER 2014

(3 hours)

FINANCIAL ACCOUNTING AND REPORTING

This paper consists of **FOUR** questions (100 marks).

1. Ensure your candidate details are on the front of your answer booklet.

2. Answer each question in black ballpoint pen only.

3. Answers to each question must begin on a new page and must be clearly numbered. Use both sides of the paper in your answer booklet.

4. The examiner will take account of the way in which answers are presented.

Unless otherwise stated, make all calculations to the nearest month and the nearest £.

All references to IFRS are to International Financial Reporting Standards and International Accounting Standards.

IMPORTANT

Question papers contain confidential information and must NOT be removed from the examination hall.

DO NOT TURN OVER UNTIL YOU ARE INSTRUCTED TO BEGIN WORK

You MUST enter your candidate number in this box.

1. The following list of balances has been extracted from the nominal ledger of Barchetta Ltd at 31 March 2014.

	Note(s)	£
Sales		4,521,000
Purchases		3,379,100
Administrative expenses		804,700
Finance costs		83,060
Plant and machinery	(1), (2)	
Cost		60,500
Accumulated depreciation at 31 March 2013		21,780
Land and buildings	(1), (3)	
Cost (land £250,000)		2,230,000
Accumulated depreciation at 31 March 2013		144,950
Retained earnings at 31 March 2013		321,370
Ordinary share capital (£1 shares)	(5)	400,000
Share premium account at 31 March 2013		75,000
Bank loan (repayable 31 March 2016)		1,100,000
Cash at bank		6,800
Inventories at 31 March 2013		27,640
Trade and other receivables		85,400
Trade and other payables		93,100

The following additional information is available:

(1) Property, plant and equipment is measured under the cost model and depreciation is charged on a straight-line basis over the following estimated useful lives:

- Buildings – 50 years
- Plant and machinery – 5 years (unless otherwise specified)

Following a review of useful lives, plant acquired on 1 April 2012 for £22,000 was estimated to have a remaining useful life of eight years at 1 April 2013. Depreciation on property, plant and equipment should be presented in cost of sales.

(2) On 1 April 2013 a machine was acquired on a six-year lease, being its estimated useful life. Six annual amounts of £3,210 are payable, commencing on 31 March 2014. The machine could have been purchased on 1 April 2013 for £15,300, equivalent at that date to the present value of the minimum lease payments. By 31 March 2014 the only accounting entry made had been to credit cash with £3,210 and recognise an equal expense in cost of sales. The interest rate implicit in the lease is 7%.

(3) On 1 April 2013 Barchetta Ltd began construction on its new head office building, which was assessed as being a qualifying asset. Barchetta Ltd already had significant borrowings in place at 1 April 2013 which funded the construction. £300,000 was paid in advance to the contractor on 1 April 2013 and a second payment of £400,000 was paid on 1 January 2014. Barchetta Ltd had the following bank loans at 31 March 2013:

- £600,000 at an interest rate of 6.4% pa
- £500,000 at an interest rate of 7.5% pa

Accounting entries made were to recognise payments to the contractor as part of buildings costs and to charge interest on the loans to finance costs. Construction of the head office building was completed on 31 May 2014.

(4) Inventories at 31 March 2014 have been valued at cost of £35,850. However, in April 2014 a review was carried out to assess customer demand. The review identified that sales of one inventory line, the Camry, were extremely low because a competitor product had been launched in February 2014 and had been selling very well at a lower price than the Camry.

At 31 March 2014 Barchetta Ltd had 200 units of the Camry in its inventory. The unit cost of the Camry was £315 and its sales price was £550. Barchetta Ltd incurs selling costs of £25 per unit. It is now thought that the Camry will need to be considerably discounted and that a realistic selling price is £320 with the same selling costs.

(5) On 1 January 2014 Barchetta Ltd made a 1 for 5 bonus issue of ordinary shares. No accounting entries have been made to reflect this bonus issue. The share premium account should be utilised for such issues wherever possible.

(6) The income tax liability for the current year has been estimated at £84,500.

Requirement

Prepare the statement of profit or loss for Barchetta Ltd for the year ended 31 March 2014 and a statement of financial position as at that date, in a form suitable for publication.

Total: 20 marks

NOTES: **Notes to the financial statements are not required.**
Expenses should be analysed by function.

2. Impreza plc is a UK company operating in the automotive industry. The financial statements for the year ended 31 March 2014 have been drafted by your assistant, although there are a number of outstanding issues which need finalising. Extracts from the draft financial statements are:

	£
Profit before tax	5,349,000
Equity	6,547,000
Liabilities (current and non-current)	2,986,000

The finance director wishes to review the completed draft financial statements and has asked you, as financial controller, for assistance with the following outstanding issues:

(1) On 1 June 2013 Impreza plc issued 450,000 5% £1 irredeemable preference shares at par. When the cash was received the issue proceeds were credited to equity. No dividend had been paid on the preference shares by 31 March 2014 and no entries had been made in the accounting records in respect of dividends. The full annual dividend for the year was subsequently paid on 31 May 2014. It transpires that the dividend payment on the irredeemable preference shares is mandatory and if it is not paid it becomes cumulative.

(2) During the year Impreza plc spent £3,570,000 developing a new automotive control system. The full amount has been recognised as part of non-current assets as it is thought that the new technology will sell well and that, at present, Impreza plc has a competitive advantage in the market due to this new technology.

The first £350,000 of this expenditure was incurred investigating alternative processes and designs. The next £700,000 was used on early development of the control system. On 1 August 2013 the development was considered to be at a stage where funding was secured for its completion and it was assessed as being commercially viable.

The remaining expenditure was incurred between 1 August 2013 and the date when the new control system was ready for sale, being 31 March 2014. On 1 February 2014 an advertising campaign was launched to market the control system and customers could place advance orders from that date. £200,000 was spent on launch activities and is included in the total development expenditure above. By 31 March 2014 £320,000 of cash deposits had been received as advance orders from customers and the cash receipts have been recognised as part of revenue for the year ended 31 March 2014.

(3) Impreza plc has a number of supplier contracts. One supplier, Murano Ltd, attracted some adverse publicity. Impreza plc therefore decided to terminate its contract with Murano Ltd on 1 March 2014 when the contract still had 18 months to run. The contract has a termination clause which states that a one-off payment of £20,000 is payable to Murano Ltd if more than six months of the contract term remains on termination. No additional amounts had been paid to Murano Ltd under the contract by the year end.

(4) During the year ended 31 March 2014 Impreza plc sold parts to a customer, Samuri Ltd, for £50,000, after giving Samuri Ltd a 20% discount. Impreza plc gives discounts to many customers varying between 5% and 25%. Rio Yukon is the managing director of Impreza plc and his daughter Aerio owns 80% of the ordinary share capital of Samuri Ltd. At 31 March 2014 £30,000 was outstanding from Samuri Ltd as part of trade receivables.

(5) On 1 October 2013 Impreza plc sold 500 units of a combined software module and a two year technical support package to a new customer for £440,000. This sum was recognised as revenue because the cash had been received before the year end. The normal selling price of a module is £1,000 and the two year technical support package is sold for 10% of the module's unit selling price.

Requirements

(a) Explain the required IFRS financial reporting treatment of the five issues above in the financial statements for the year ended 31 March 2014, preparing all relevant calculations. **(24 marks)**

(b) Calculate revised figures for Impreza plc's profit before tax, equity and liabilities for inclusion in the financial statements for the year ended 31 March 2014. **(6 marks)**

(c) Explain how the requirements of IAS 18, Revenue, apply the accrual basis and the IASB's Conceptual Framework's recognition criteria. **(4 marks)**

Total: 34 marks

3. The following information has been extracted from Vitara plc's draft consolidated financial statements for the year ended 31 March 2014.

Consolidated statement of profit or loss (extracts)

	£
Depreciation charge	127,200
Profit after tax	496,500

Consolidated statement of financial position (extracts)

	£
Property, plant and equipment	1,156,300
Total assets	1,673,500

Consolidated statement of cash flows (extract)

	£
Net cash from investing activities	316,700

The draft consolidated financial statements of Vitara plc were incomplete due to the following outstanding issues:

(1) On 1 April 2013 Vitara plc stopped using equipment which had a carrying amount of £20,000 at that date and the equipment was advertised for sale. The equipment had originally cost £56,000 and had a useful life of seven years. The fair value of the equipment was estimated at £17,000 on 1 April 2013 and costs to sell were estimated at £500. The equipment is included in the property, plant and equipment figure above and depreciation was charged at the year end as the equipment had not been sold at this time.

(2) On 1 January 2014 a piece of plant was no longer used by Vitara plc due to obsolescence. The plant had been acquired on 1 April 2006 for £15,000 and was being depreciated at 10% pa on a straight-line basis. The plant is included in the property, plant and equipment figure above and a full year's depreciation was charged at the year end.

(3) Property, plant and equipment had been acquired during the year and was correctly included in the property, plant and equipment figure above. The amount included in the statement of cash flows was £280,000 being the increase in property, plant and equipment during the period (ie the carrying amount at 31 March 2014 less the carrying amount at 31 March 2013). There have been no disposals of property, plant and equipment during the period. All additions were acquired for cash except for the following:

- Early in 2014 Vitara plc acquired a subsidiary which had property, plant and equipment with a carrying amount of £151,200 at the date of its acquisition by Vitara plc. There was no difference between the carrying amount and fair value of these assets.

- On 1 April 2013 Vitara plc acquired a piece of plant with a fair value of £72,000 on two years' interest free credit. The plant was correctly included in the property, plant and equipment figure above and the correct finance cost was recognised in the statement of profit or loss.

(4) On 1 April 2013 equipment with a carrying amount of £24,500 was damaged in one of Vitara plc's warehouses, although the equipment is still being used and had an estimated value in use of £18,000 at that date. The equipment's fair value at 1 April 2013 was estimated at £18,500 with costs to sell of £800. At 1 April 2013 the equipment had an estimated remaining useful life of three years. No accounting entries have been made for the year ended 31 March 2014 in respect of this equipment.

(5) On 1 October 2013 Vitara plc purchased 90% of the ordinary share capital of Tredia Ltd. Extracts from the draft consolidated statement of profit or loss, excluding the acquisition of Tredia Ltd, for the year ended 31 March 2014 and the individual statement of profit or loss of Tredia Ltd for the same period are shown below:

	Vitara plc group (draft consolidated)	**Tredia Ltd**
	£	**£**
Revenue	1,395,600	356,000
Cost of sales	(793,200)	(193,500)
Gross profit	602,400	162,500

During the period from 1 October 2013 to 31 March 2014, Vitara plc sold goods to Tredia Ltd for £46,000, at a mark-up of 15% on cost. Half of these goods were still in Tredia Ltd's inventory at the year end.

Requirements

(a) Using the information in (1) to (4) above:

(i) prepare revised extracts from Vitara plc's consolidated statement of financial position as at 31 March 2014 and consolidated statement of cash flows for the year then ended showing property, plant and equipment, total assets and net cash from investing activities.

(ii) calculate the revised consolidated profit after tax and depreciation charge for the year ended 31 March 2014. **(12 marks)**

(b) Using the information in (5) above:

(i) prepare a revised extract from Vitara plc's consolidated statement of profit or loss for the year ended 31 March 2014, showing revenue and cost of sales; and

(ii) explain the required IFRS financial reporting treatment of the goods sold by Vitara plc to Tredia Ltd in the consolidated financial statements of Vitara plc for the year ended 31 March 2014. Make reference to the IASB's Conceptual Framework's qualitative characteristic of faithful representation, where relevant. **(7 marks)**

Total: 19 marks

PLEASE TURN OVER

4. Altima plc has investments in three companies, Fuego Ltd, Previa Ltd and Tacoma Ltd. A draft consolidated statement of financial position as at 31 March 2014 has been prepared by an interim manager, an ICAEW Chartered Accountant, who has little recent experience of consolidation.

Goodwill was not calculated for any acquisitions and 'Investments' consists of the purchase consideration for all three acquisitions. Figures for Tacoma Ltd were not available at the date the interim manager prepared the financial statements, therefore Tacoma Ltd was excluded from the draft consolidation (Fuego Ltd's figures were included). The only figure included for Previa Ltd in the draft consolidation is the acquisition cost.

Ciera Durango, the financial controller, who is also an ICAEW Chartered Accountant, is concerned that impairments in relation to all three investments have been identified. Ciera was involved in the investment decisions and is worried about the impact that showing these impairments might have on her current position at Altima plc.

An extract from the draft consolidated statement of financial position as prepared by the interim manager is shown below, together with the individual statement of financial position of Tacoma Ltd:

	Altima plc group (draft consolidated)	Tacoma Ltd
Non-current assets	**£**	**£**
Property, plant and equipment	2,140,050	496,000
Investments	1,583,750	–
	3,723,800	496,000
Current assets		
Inventories	191,300	49,700
Trade and other receivables	86,600	56,600
Cash and cash equivalents	55,000	5,450
	332,900	111,750
Total assets	4,056,700	607,750
Total liabilities	556,050	54,150

Additional information:

(1) Details of Altima plc's three investments are set out below:

	Fuego Ltd	**Previa Ltd**	**Tacoma Ltd**
Date of acquisition	1 April 2010	1 July 2011	1 April 2013
Percentage holding acquired	80%	40%	75%
Consideration	£820,000	£283,500	£480,250
Retained earnings at the date of acquisition	£236,700	£67,000	£126,800
Goodwill and non-controlling interest method	Proportionate basis	N/A	Fair value basis
Impairment of goodwill for year ended 31 March 2014	£15,000	–	£21,000
Impairment of investment for year ended 31 March 2014	–	£24,000	–

(2) The fair value of the non-controlling interest at the date of acquisition of Tacoma Ltd was £150,000. There had been no impairments of goodwill or investments prior to 1 April 2013.

(3) An extract from the equity section of the individual financial statements of the four companies at 31 March 2014 is shown below. No shares have been issued during the year by any of the four companies.

	Altima plc £	Fuego Ltd £	Previa Ltd £	Tacoma Ltd £
Ordinary share capital	1,500,000	420,000	300,000	400,000
Share premium account	500,000	160,000	–	50,000
Retained earnings	548,900	371,750	96,900	103,600
Total equity	2,548,900	951,750	396,900	553,600

(4) At the date of acquisition the fair values of the assets, liabilities and contingent liabilities of Fuego Ltd, Previa Ltd and Tacoma Ltd were equal to their carrying amounts, with the following exceptions:

(i) Previa Ltd had an item of plant which had a fair value £30,000 in excess of its carrying amount. The plant had a remaining useful life of six years at 1 July 2011, the date that Altima plc acquired its shares in Previa Ltd.

(ii) Fuego Ltd has internally generated brands which were not recognised in Fuego Ltd's own financial statements and the interim manager did not include them in the draft consolidated financial statements. An independent expert valued the brands at £150,000, with a useful life of five years, at 1 April 2010, the date of acquisition of Fuego Ltd by Altima plc.

(5) During the year ended 31 March 2014 Altima plc sold goods to Previa Ltd for £24,000 with a gross profit margin of 15%. At the year end Previa Ltd still held these goods in its inventories.

Requirements

(a) Prepare the consolidated statement of financial position of Altima plc as at 31 March 2014. **(18 marks)**

(b) Describe the UK GAAP financial reporting treatment of the goodwill recognised on the acquisition of Tacoma Ltd and calculate the impact of applying this UK GAAP treatment on the consolidated financial statements of Altima plc for the year ended 31 March 2014. **(5 marks)**

(c) Identify and explain any ethical issues arising for Ciera and the interim manager and explain any action Ciera should take. **(4 marks)**

Total: 27 marks

MARK PLAN AND EXAMINER'S COMMENTARY

The mark plan set out below was that used to mark these questions. Markers are encouraged to use discretion and to award partial marks where a point was either not explained fully or made by implication. More marks are available than could be awarded for each requirement, where indicated. This allows credit to be given for a variety of valid points, which are made by candidates.

Question 1

Overall marks for this question can be analysed as follows: **Total: 20**

General comments
This question required the preparation of the statement of profit or loss and statement of financial position. A number of adjustments were required to be made, including depreciation, borrowing costs, an inventory write down, a bonus issue and a finance lease.

Barchetta Ltd – Statement of financial position as at 31 March 2014

	£	£
ASSETS		
Non-current assets		
Property, plant and equipment (2,087,050 (W4) + 41,570 (W5))		2,128,620
Current assets		
Inventories (W2)	31,850	
Trade and other receivables	85,400	
Cash and cash equivalents	6,800	
		124,050
Total assets		2,252,670
Equity		
Ordinary share capital (400,000 x 6/5)	480,000	
Retained earnings (W7)	481,909	
Equity		961,909
Non-current liabilities		
Bank loan	1,100,000	
Finance lease (W6)	10,872	
		1,110,872
Current liabilities		
Trade and other payables	93,100	
Finance lease (13,161 – 10,872)	2,289	
Taxation	84,500	
		179,889
Total equity and liabilities		2,252,670

Barchetta Ltd – Statement of profit or loss for the year ended 31 March 2014

	£
Revenue	4,521,000
Cost of sales (W1)	(3,409,730)
Gross profit	1,111,270
Administrative expenses	(804,700)
Operating profit	306,570
Finance charges (83,060 – 27,600 (W3) + 1,071 (W6))	(56,531)
Profit before tax	250,039
Income taxation	(84,500)
Net profit for the period	165,539

W1 Expenses

	Cost of sales
Trial balance	3,379,100
Opening inventories	27,640
Closing inventories (W2)	(31,850)
Depreciation charge – building (W4)	25,600
Depreciation charge – plant & machinery (W5)	12,450
Reverse lease payment	(3,210)
	3,409,730

W2 Inventory

	£
Closing inventory	35,850
Inventory write down (200 x (315 – (320 – 25))	(4,000)
At 31 March 2014	31,850

W3 Borrowing costs

Weighted average cost of loans = $\frac{(600{,}000 \times 6.4\%) + (500{,}000 \times 7.5\%)}{1{,}100{,}000}$ = 6.9%

Borrowing costs to be capitalised = (300,000 + (400,000 x 3/12)) x 6.9% = 27,600

W4 PPE – Building

	£	£
Cost b/f		2,230,000
Depreciation charge for year		
((2,230,0000 – 250,000 – 700,000)/ 50 yrs)		(25,600)
Accumulated depreciation		(144,950)
Borrowing costs (W3)		27,600
Carrying amount at 31 March 2014		2,087,050

W5 PPE – Plant and equipment

	£	£
Cost b/f		60,500
Depreciation charge for the year		
(60,500 – 22,000) / 5yrs)	(7,700)	
Plant – different useful life		
((22,000 x 4/5) / 8yrs)	(2,200)	
Leased equipment (15,300 / 6yrs)	(2,550)	
		(12,450)
Accumulated depreciation b/f		(21,780)
Leased equipment		15,300
Carrying amount at 31 March 2014		41,570

W6 Finance lease

	Opening balance £	Interest @ 7% £	Lease payment £	Closing balance £
31 March 2014	15,300	1,071	(3,210)	13,161
31 March 2015	13,161	921	(3,210)	10,872

W7 Retained earnings

	£
Per draft	321,370
Add: profit and loss in year	165,539
Bonus issue (75,000 – (400,000 / 5))	(5,000)
	481,909

Presentation of the statement of profit or loss and statement of financial position was generally very good with most candidates achieving the maximum presentation marks available.

A significant majority of candidates arrived at completely correct figures in respect of closing inventories, the finance lease, and the bonus issue. It was rare to see a completely correct figure for property, plant and equipment, although this was usually due to errors on land and buildings as opposed to plant and machinery. It was less common to see the correct figure for capitalised interest, although almost all candidates made a good attempt at this calculation, with nearly all candidates arriving at the correct effective interest rate. However, most candidates went on to apply that rate to the whole £1,100,000 borrowed or to the whole £700,000 paid to the contractor, instead of taking into account that £400,000 of that amount had only been paid four months before the year end.

Most candidates provided relatively clear workings for their property, plant and equipment figure. The most common error was to not remove the amounts paid to the contractor before calculating the depreciation on buildings.

The vast majority of candidates used a "costs matrix" to calculate the figure for cost of sales, and many correctly allocated all of the costs to this category. The most common errors were to fail to deduct the finance lease payment incorrectly included (even where the candidate had "used" this figure in their finance lease working) and/or not to include all of the depreciation figures to cost of sales. This is despite the question itself specifying that depreciation should be presented under this expense heading. Weaker candidates often got themselves in a muddle in this working, mixing up their bracket convention.

Total possible marks	22½
Maximum full marks	20

Question 2

Overall marks for this question can be analysed as follows: **Total: 34**

General comments
Part (a) of this question required candidates to explain the financial reporting treatment of five accounting issues, given in the scenario. The five issues covered the irredeemable preference shares, research and development, an onerous contract, revenue recognition and a related party transaction.
Part (b) required candidates to recalculate profit before tax, equity and liabilities for the adjustments needed as a result of their answer to Part (a).
Part (c) required candidates to discuss and compare the accrual basis of accounting with cash accounting with reference to revenue recognition and the Framework's recognition criteria.

Impreza plc

(a) IFRS accounting treatment

(1) Irredeemable preference shares

The irredeemable preference shares provide the investor with the right to receive a fixed (5% pa) amount of annual dividend out of Impreza plc's profit for the period on a mandatory basis. If the annual dividend is not paid then it is rolled up into the following year's payment as the dividends are cumulative in nature.

Under IAS 32 Financial Instruments: Presentation, these shares should be classified as financial liabilities as there is a contractual obligation to deliver cash. The preference shares should therefore be accounted for at amortised cost using the effective interest rate which is equivalent to the annual dividend rate of 5% as they are not redeemable. This reflects the substance of the share issue.

£450,000 should therefore be recognised as part of non-current liabilities and removed from equity and the dividend payment of £18,750 (450,000 x 5% x 10/12) should be accrued for at 31 March 2014 and included within finance costs in the statement of profit or loss.

(2) Research and development

As per IAS 38, Intangible Assets, distinction needs to be made between research and development expenditure as expenditure incurred during the research phase should be recognised as an expense in profit or loss when it occurs. During the research phase there is insufficient evidence that the expenditure will generate future economic benefits.

The first £350,000 of expenditure was incurred during investigation work and is therefore classed as research expenditure and should have been recognised as an expense in the statement of profit or loss.

Although expenditure incurred after this initial work is all development work, in order for it to be capitalised as an intangible asset Impreza plc needs to meet strict criteria including:

- The technical feasibility of completing the asset
- The intention to complete the asset
- The ability to use the asset
- Demonstrate the commercial viability of the asset
- The availability of adequate resources
- Reliable measurement of expenditure

Therefore all of the development expenditure incurred up to 31 July 2013, ie £700,000, should be recognised as an expense as part of profit or loss because the asset was not commercially viable until that date.

On 1 August 2013 the asset met all the capitalisation criteria and therefore qualifying expenditure should be capitalised from this date. The £200,000 incurred on launch activities is not qualifying expenditure because it does not involve design, construction or testing and this should be expensed when incurred. The remaining balance of £2,320,000 (3,570,000 – 350,000 – 700,000 – 200,000) should be capitalised.

Amortisation should commence when the asset is available for use. Although the control system was promoted from 1 February 2014 it was not ready for use until 1 April 2014. Therefore at 31 March 2014, no amortisation should be recognised. However, an impairment review should be carried out to ensure that its recoverable cost is not less than the carrying amount.

The £320,000 cash received before the year end for pre-orders is effectively deposits, and at this date the risks and rewards have not transferred to the customers as the control system technology has not been delivered to them. These amounts should therefore not be recognised as part of revenue, but instead should be held as deferred income as part of current liabilities.

(3) Onerous contract

The contract with Murano Ltd constitutes an onerous contract at 1 March 2014. IAS 37 Provisions, Contingent Liabilities and Contingent Assets, defines an onerous contract as one in which the unavoidable costs of meeting the obligation under the contract exceeds the economic benefits expected to be received under it. The standard requires that where an onerous contract exists, the present obligation under the contract should be recognised and measured as a provision.

Imprezo plc has made the decision to terminate the contract with Murano Ltd before the year end and the unavoidable costs of meeting the obligation is the termination payment of £20,000. No benefit is expected under the contract and therefore a provision should be made at 31 March 2014 of £20,000, with the corresponding amount recognised in profit or loss.

(4) Related party

Imprezo plc will need to establish whether or not the sale of goods to Samuri Ltd is a related party transaction under IAS 24, Related Party Disclosures.

Samuri Ltd is controlled by one of the close members (ie his daughter) of the family of a member of Imprezo plc's key management personnel, so Samuri Ltd is a related party of Imprezo plc under IAS 24. Therefore, the sale of goods is a related party transaction.

Disclosure should include the nature of the related party relationship, ie one of the directors daughter's owns a majority share in Samuri Ltd, the amount of the transaction, ie £50,000, and whether there are any outstanding balances at the year end, ie £30,000 is outstanding.
The rate of the discount and the names of the related parties do not need to be disclosed under IAS 24.

(5) Revenue recognition

Where a combined package of goods and services is sold, the separate components need to be identified, then measured and recognised separately.

Where the total of the individual fair values exceed the combined package price then the discount needs to be applied to each component in an appropriate manner. Where there is no evidence of how the discount should be applied then the same discount should be applied to each component.

The total package price is £440,000 whereas to acquire the components separately it would have cost £550,000 (£1,000 x 110% x 500 units), so a discount of 20% was given. The two components should therefore be measured at:

- Software module – £1,000 x 500 x 80% = £400,000
- Technical support – (£1,000 x 10%) x 500 x 80% = £40,000 (or £400,000 x 10%)

The revenue for the software module should be recognised immediately as the goods have been transferred. However, the technical support is for 24 months and therefore should be recognised on a straight-line basis, assuming no other basis is more appropriate, over the 24 months. Therefore, revenue of £10,000 (£40,000 x 6/24) should be recognised in the year ended 31 March 2014 in relation to the technical support, with the remaining £30,000 being recognised as deferred income.

The deferred income should be split between current of £20,000 (£40,000 x 12/24) and non-current of £10,000.

Virtually all candidates addressed all five issues and included narrative explanations as well as relevant calculations. However, explanations were often superficial and/or didn't use all of the information given in the scenarios and hence candidates missed out on available marks as a result. A minority of candidates incorrectly assumed that giving journal entries is a valid alternative to narrative explanations.

Most candidates correctly identified the underlying issues. It was particularly pleasing that nearly all candidates identified the related party transaction as an issue as this was overlooked entirely by many candidates in a previous sitting.

The calculations for the development costs to be capitalised and the splitting of revenue for the combined sales package were frequently correct. Most candidates also correctly identified that the irredeemable preference shares should be treated as debt in the scenario due to mandatory, cumulative dividends, that the deposits received in advance should not be recognised in revenue, that the onerous contract should be provided for and that related party disclosures were needed.

The most common errors were not time apportioning the preference share dividend, allowing the capitalisation of development costs before the relevant criteria were met and incorrectly apportioning the revenue on the combined package being sold (normally by misunderstanding how to deal with the discount given).

Total possible marks	31
Maximum full marks	24

(b)

Imprezo plc

	Profit before tax		Equity	Liabilities
	£	£	£	£
As stated		5,349,000	6,547,000	2,986,000
(1) Irredeemable preference shares	–		(450,000)	450,000
(1) Interest - prefs	(18,750)		–	18,750
(2) R&D (350,000+700,000)	(1,050,000)		–	–
(2) R&D – launch activities	(200,000)		–	–
(2) Customer deposits	(320,000)		–	320,000
(3) Onerous contract	(20,000)		–	20,000
(5) Revenue (440,000 – 410,000)	(30,000)		–	30,000
		(1,638,750)	(1,638,750)	–
TOTAL		3,710,250	4,458,250	3,824,750

The majority of candidates made a good attempt at making the relevant adjustments to profit, equity and liabilities. A significant number of candidates achieved at least five and often all six marks available. It should be remembered that this part of the question has an own figure rule and therefore candidates can gain full marks on this part of the question regardless of whether their answers to part (a) were totally correct. The most worrying and common error was failing to adjust equity for the net impact of the adjustments to profit, highlighting that candidates continue not to think through or understand properly the link between the various elements of the financial statements.

Total possible marks	6½
Maximum full marks	6

(c) IAS 18 Revenue, accruals accounting and the Framework

Revenue is recorded when there is an increase in economic benefits during the period and the amount can be measured reliably in accordance with the IASB Conceptual Framework. The Framework states that an entity should assess the degree of certainty that economic benefits will flow to the entity. Hence revenue can only be recognised when an entity is sufficiently certain that it will be paid for the goods or services and that payment is for a known amount.

The accrual basis of accounting is followed with revenue being recognised in the period in which the associated work is undertaken rather than when cash is received to provide a faithful representation in accordance with the Framework.

IAS 18 provides additional guidance to assess the timing of when the economic benefits will flow to the entity:

- Has the entity transferred the significant risks and rewards of ownership of the goods to the buyer?
- Does the seller still have management involvement or effective control over the goods?
- Can the amount of revenue and costs be measured reliably? Has a price been agreed?
- Is it probable that the economic benefits associated with the transaction will flow to the entity? Has a payment date been agreed, is the customer likely to pay on time?

When an entity has met all the above conditions it recognises the revenue even though payment may still be outstanding.

Consistent with previous sittings answers to the "conceptual" requirement were rather disappointing and were often too brief. However, most candidates attempted to answer this and normally gained at least a couple of marks by discussing the recognition criteria in IAS 18 and/or the key recognition criteria from the Conceptual Framework.

Total possible marks	6
Maximum full marks	4

Question 3

Overall marks for this question can be analysed as follows: **Total: 17**

General comments
This question was a mixed topic question, with part (a) covering property, plant and equipment and part (b) covering the revised preparation of a consolidated statement of profit or loss, along with an explain element in relation to inter-company trading.

Vitara plc

(i)

Consolidated statement of financial position as at 31 March 2014 (extracts)

Property, plant and equipment (W4)	1,128,800
Total assets (1,673,500 + 16,500 – 27,500 (W4))	1,662,500

Consolidated statement of cash flows for the year ended 31 March 2014 (extract)

Net cash from investing activities (316,700 + 280,000 – 184,000 (W5))	412,700

(ii)

Profit after tax

	£
Draft profit after tax	496,500
Held for sale asset – impairment (W1)	(3,500)
Scrapped plant – write-off	(3,375)
Depreciation (8,375 – 6000)	2,375
Impairment loss	(6,500)
	485,500

Depreciation charge

		£
Depreciation		127,200
Impaired equipment (W3)		6,000
Held for sale asset – reverse depreciation (56,000 / 7yrs)	(8,000)	
Scrapped plant – reverse depreciation (15,000 x 10% x 0.25)	(375)	
		(8,375)
Depreciation charge		124,825

Workings

(1) Held for sale asset

	£
Carrying amount at 1 April 2013	20,000
Fair value less costs to sell (17,000 – 500)	(16,500)
Impairment	3,500

(2) Obsolete plant

Cost	15,000
Acc depreciation (15,000 x 10% x 7.75 years)	(11,625)
	3,375

(3) Impaired equipment

	£
Carrying amount	24,500
Recoverable amount	(18,000)
Impairment	6,500
Depreciation in year (18,000 / 3yrs)	6,000

(4) Property, plant and equipment

B/fwd		1,156,300
(1) Held for sale asset (20,000 – 8,000)	(12,000)	
(2) Obsolete plant (3,375 – 375)	(3,000)	
(3) Impaired equipment	(6,500)	
- depreciation	(6,000)	
		(27,500)
		1,128,800

(5) PPE – cash movement

	£		£
B/fwd (1,156,300 – 280,000)	876,300		
Acquisition of subsidiary	151,200	Depreciation	127,200
Plant on credit terms	72,000		
Additions (β)	184,000	C/fwd	1,156,300
	1,283,500		1,283,500

Most candidates appeared to produce a random set of quite messy and unreferenced workings, rather than a methodical approach which would have gained the most marks. This rather scattergun approach to this part of the question meant that candidates often omitted figures in workings.

The impairment for the held for sale asset was calculated correctly by many candidates as was the carrying amount for the obsolete plant. The impairment of the equipment and depreciation were again calculated reasonably well by the majority of candidates. The most common error here was to use fair value less costs to sell as the recoverable amount even though value in use was higher.

Most candidates made a reasonable attempt at calculating the depreciation charge, with the most common error being to add rather than subtract the depreciation.

In most cases candidates made some attempt at the various calculations but then transferring these calculated figures to the correct totals in the financial statements was less well done.

The adjustments which seemed to cause candidates the biggest problem were the adjustments to the statement of cash flows. Only a minority of candidates completed this calculation correctly. It was concerning that so many candidates appeared unfamiliar with double entry principles in respect of this issue.

A number of candidates also wasted time explaining the treatment alongside each of their workings. Candidates are reminded to read the requirement carefully and if the "explain" verb is not used, then no such explanation is required or will have marks allocated to it.

Total possible marks	15
Maximum full marks	12

(b) (i)

Extract from consolidated statement of profit or loss for year ended 31 March 2014

	£
Revenue	1,527,600
Cost of sales	(846,950)
Gross profit	680,650

Workings

(1) Consolidation schedule

	Vitara plc	6/12 Tredia Ltd	Adj	Consol
	£	£	£	£
Revenue	1,395,600	178,000	(46,000)	1,527,600
Cost of sales – per Q	(793,200)	(96,750)	46,000	(846,950)
– PURP (W6)	(3,000)			

(2) PURP

	%	£
SP	115	46,000
Cost	(100)	(40,000)
GP	15	6,000
X $^{1}/_{2}$		3,000

(ii) Intra-group balances IFRS financial reporting treatment

When one company in a group sells goods to another group member an identical amount is added to the revenue of the first company and to the cost of sales of the second. Yet as far as the entity's dealings with third parties are concerned no sale has taken place. Consolidated financial statements are based on the concept of substance over form which means that although Vitara plc and Tredia Ltd are two separate entities they are instead accounted for as a single entity. Substance over form is implied in faithful representation.

The consolidated figures for sales revenue and cost of sales should represent sales to and purchases from third parties. An adjustment is therefore necessary to reduce the sales revenue and cost of sales figure by the value of intra-group sales made during the year.

An adjustment is therefore required to deduct the intra-group sales from both consolidated revenue and cost of sales.

If any of the inventory remains within a group company at the year end its value must be adjusted to the lower of cost and net realisable value to the group, applying the single entity concept. This is because these items have not been sold outside the group and therefore contain unrealised profit, so this element is removed from closing inventory (ie cost of sales).

The most common errors were to either not pro-rata Tredia Ltd's figures for only six months of ownership or to subtract the PURP figures from cost of sales rather than adding it.

The explanation of the treatment of inter-company trading between a parent and subsidiary was disappointing. Almost all candidates understood that inter-company trading should be removed from the consolidated financial statements although far fewer candidates were able to explain why this was the case. This suggests a rote learning approach to their studies with insufficient time allocated to understanding the principles that lie behind the treatment of transactions.

Total possible marks	9½
Maximum full marks	7

Question 4

Overall marks for this question can be analysed as follows: **Total: 27**

Part (a) of this question required the preparation of a revised consolidated statement of financial position from draft information. The group had two subsidiaries, one of which was acquired during the year, and an associate. Fair value adjustments were required on acquisition of the associate and one of the subsidiaries. Impairments in all three companies had taken place during the period. Inter-company trading took place during the year between the parent and the associate.
Part (b) required a comparison between IFRS and UK GAAP in respect of the calculation of goodwill for the subsidiary acquired using the fair value method for calculating goodwill and NCI, including calculations under UK GAAP.
Part (c) required a discussion of the ethical issues arising from the scenario.

Altima plc

Consolidated statement of financial position as at 31 March 2014

Assets	**£**	**£**
Non-current assets		
Property, plant and equipment (2,140,050 + 496,000)		2,636,050
Investment in associate (W5)		264,520
Intangible (150,000 – 120,000)		30,000
Goodwill (31,640 + 32,450) (W3 & W4)		64,090
		2,994,660
Current assets		
Inventories (191,300 + 49,700)	241,000	
Trade and other receivables (86,600 + 56,600)	143,200	
Cash and cash equivalents (55,000 + 5,450)	60,450	
		444,650
Total assets		3,439,310
Equity and liabilities		
Equity		
Ordinary share capital		1,500,000
Share premium account		500,000
Retained earnings (W6)		493,810
Attributable to the equity holders of Altima plc		2,493,810
Non-controlling interest (W5)		335,300
		2,829,110
Total liabilities (556,050 + 54,150)		610,200
Total equity and liabilities		3,439,310

Workings

(1) Net assets – Fuego Ltd

	Year end £	**Acquisition £**	**Post acq £**
Share capital	420,000	420,000	
Share premium	160,000	160,000	
Retained earnings	371,750	236,700	
Brands – intangible asset	150,000	150,000	
Amortisation (150,000/5 yrs x 4)	(120,000)	–	
	981,750	966,700	15,050

(2) Net assets – Tacoma Ltd

	Year end £	**Acquisition £**	**Post acq £**
Share capital	400,000	400,000	
Share premium	50,000	50,000	
Retained earnings	103,600	126,800	
	553,600	576,800	(23,200)

(3) Goodwill – Fuego Ltd

	£
Consideration transferred	820,000
Non-controlling interest at acquisition (966,700 x 20%)	193,340
Less: Net assets at acquisition (W1)	(966,700)
	46,640
Impairment	(15,000)
	31,640

(4) Goodwill – Tacoma Ltd

	£
Consideration transferred	480,250
Non-controlling interest at acquisition at fair value	150,000
Less: Net assets at acquisition (W2)	(576,800)
	53,450
Impairment	(21,000)
	32,450

(5) Investment in associate – Previa Ltd

	£
Cost of investment	283,500
Share of post acquisition increase in net assets ((96,900 – 67,000) x 40%)	11,960
Share of additional depreciation on FV uplift ((30,000 / 6yrs x 2.75 yrs) x 40%)	(5,500)
PURP (W7)	(1,440)
Less: Impairment	(24,000)
	264,520

(6) Non-controlling interest

	£	£
Tacoma Ltd		
At acquisition	150,000	
Share of post-acquisition reserves ((23,200) (W2) x 25%)	(5,800)	
Impairment (21,000 x 25%)	(5,250)	
		138,950
Fuego Ltd		
At acquisition	193,340	
Share of post-acquisition reserves (15,050 (W1) x 20%)	3,010	
		196,350
		335,300

(7) PURP

	%	Sales in year £
Selling price	100	24,000
Cost	(85)	(20,400)
Gross profit	15	3,600

Previa Ltd - £3,600 x 40% = £1,440

(8) Retained earnings

	£
Altima plc	548,900
Tacoma Ltd (75% x (23,200) (W2))	(17,400)
Fuego Ltd (80% x (15,050 (W1))	12,040
Previa Ltd (W5)	11,960
PURP – Previa Ltd (W7)	(1,440)
FV depreciation – Previa Ltd (W5)	(5,500)
Impairment – Previa Ltd (W5)	(24,000)
Impairment – Tacoma Ltd (21,000 x 75%)	(15,750)
Impairment – Fuego Ltd	(15,000)
	493,810

Candidates' performance on this question was again, excellent, and they were clearly well-prepared. Almost all produced the "standard" workings for net assets, goodwill, non-controlling interest, investment in associate and retained earnings. Presentation of the consolidated statement of financial position was generally good, although there were some messy attempts. Almost all candidates included a figure for non-controlling interest, for which they were rewarded. The most common omission from the more straightforward figures was the figure for total liabilities. Of the other figures, many who adjusted for the brand in the net assets working for Fuego Ltd failed to include the closing balance of that brand in intangibles on the consolidated statement of financial position. Most candidates included a figure for goodwill, but some lost marks where there was no audit trail showing clearly that this was the sum of their two goodwill calculations for the two subsidiaries.

In the two sets of net assets workings, almost all candidates dealt correctly with share capital, share premium and retained earnings. This meant that the figures for Tacoma Ltd were generally correct, and most candidates then went on to calculate goodwill for this subsidiary correctly, dealing correctly with non-controlling interest on the fair value basis. Some, however, then fell down in the retained earnings working, failing to show the downwards movement on post-acquisition profits as a debit, as opposed to a credit (with the same error made in the non-controlling interest working).

In the net assets working for Fuego Ltd, a good number of candidates dealt correctly with the fair value adjustment in respect of the brand. Where mistakes were made on this they were generally making the adjustment(s) in the wrong direction, adjusting only for the fair value of the brand at acquisition, but not for the subsequent amortisation, or miscalculating the subsequent amortisation. Most candidates then went on from this to produce correct (own) figures for goodwill and retained earnings.
Although most candidates were able to deal with calculating gross goodwill on both a fair value and a proportionate basis, a few allocated only the group share of the impairment on the fair value basis.

Most candidates arrived at the correct total provision for unrealised profit, but many then failed to account for only the group share (40%) of that figure. Others credited their figure to inventories instead of to the investment in associate figure. The depreciation adjustment seemed to cause the most problems with few candidates arriving at the correct figure and many adjusting for the increase in fair value on the plant itself instead of just for the additional depreciation. Of those who attempted this figure, the most common errors were to adjust for only one year of depreciation, instead of two years and nine months, and/or to account for the whole figure instead of only the group share.

Total possible marks	20½
Maximum full marks	18

(b) UK GAAP treatment

UK GAAP is more restrictive than IFRS in respect of the calculation of goodwill and does not permit a choice to be made. Under UK GAAP, the non-controlling interest, which is known as the minority interest, is always calculated using the share of net assets (ie the proportionate basis).

Goodwill calculated using the proportionate basis is usually lower than that under the fair value method.

Goodwill – Tacoma Ltd

	£
Consideration transferred	480,250
Minority interest at acquisition (576,800 x 25%)	144,200
Less: Net assets at acquisition (W2)	(576,800)
	47,650
Impairment	(21,000)
	26,650

Under UK GAAP there would be a decrease in consolidated non-current assets, representing goodwill, of £5,800 (£32,450 – £26,650).

Goodwill should be amortised over its estimated useful economic life under UK GAAP and there is a rebuttable presumption that this is not more than 20 years. Although annual impairment reviews are not required under UK GAAP if an impairment was identified this would be recognised as above.

As the proportionate method is applied under UK GAAP none of the impairment is allocated to the non-controlling interest (minority interest). Hence, reporting under UK GAAP will also affect the non-controlling interest and the retained earnings as reported in the consolidated financial statements of Altima plc.

	£	£
Tacoma Ltd		
At acquisition (576,800 x 25%)	144,200	
Share of post-acquisition reserves ((23,200) (W2) x 25%)	(5,800)	
		138,400
Fuego Ltd		196,350
Minority interest		334,750
Retained earnings (per part (a))		493,810
Additional impairment re Tacoma Ltd (21,000 x 25%)		(5,250)
		488,560

Nearly all candidates stated that only the proportionate method is available under UK GAAP and most also attempted to recalculate the goodwill figure. The majority also identified that goodwill would be amortised although a significant number of candidates appear to believe that this should always be over twenty years. Only the stronger candidates understood that impairment reviews might still be needed and could clearly explain the impact of this on retained earnings/ NCI when the proportionate rather than fair value method is used.

Many candidates wasted time by writing out other differences that were not relevant in this particular scenario, such as the treatment of any "negative" goodwill arising and of acquisition costs.

Total possible marks	8½
Maximum full marks	5

(c)

Chartered accountants must always abide by the spirit of the five fundamental ethical principles. One of these is professional competence and due care.

The professional competence of the interim manager should be questioned. He has a responsibility to maintain his continuing professional development to the appropriate level required for his current position. For the interim manager this will include keeping his technical knowledge and skills completely up to date as he is accepting contracts which require him to perform the preparation of consolidated financial statements and therefore his skills in this area should be exemplary.

If the interim manager's technical knowledge and skills are lacking in the area of financial statement preparation it is likely that his general accounting ability should be questioned. This would include whether or not he is capable of carrying out an impairment review in a competent manner.

However, assuming that there is doubt over the carrying amounts of the three investments, Ciera should carry out her own impairment review to confirm or otherwise the valuations. As an ICAEW Chartered Accountant Ciera needs to ensure that she acts with integrity, demonstrating high standards of both professional behaviour and conduct. There is a self-interest threat here as Ciera's position in Altima plc may be under threat because impairments appear to have arisen on acquisitions in which she was involved. However, her judgement should not be influenced by the fact that her competence may be questioned if large impairments arise from investment decisions she was involved in, remembering that another of the five fundamental principles is professional behaviour.
As in previous sittings, many candidates produced a "stock" answer rather than referring specifically to the scenario. Candidates must look at who they are and what their position is. In this question there was no management pressure and therefore discussions with the ICAEW Ethics Helpline was not seen as appropriate. However, most candidates made a reasonable attempt at this part of the question, with a good number obtaining half marks.

Total possible marks Maximum full marks	6½ 4

MARK PLAN AND EXAMINER'S COMMENTARY

The mark plan set out below was that used to mark these questions. Markers are encouraged to use discretion and to award partial marks where a point was either not explained fully or made by implication. More marks are available than could be awarded for each requirement, where indicated. This allows credit to be given for a variety of valid points, which are made by candidates.

Question 1

Overall marks for this question can be analysed as follows: **Total: 16**

General comments

This question requires candidates to revise a draft income statement and statement of financial position for a number of adjustments. In addition, candidates are required to prepare the retained earnings column from the statement of changes in equity. The amendments are in relation to the incorrect classification of preference shares, capitalisation of development expenditure which did not meet the IAS 38 criteria, a foreign exchange transaction, the discounting of a provision, the correction of an error and an income tax adjustment.

Portway Ltd **Statement of financial position as at 31 March 2012**			**Marks**
	£	**£**	+ 1 pres
ASSETS			
Non-current assets			1 b/fwds
Property, plant and equipment (338,810 + 12,709)		351,519	½
Intangibles (237,600 – 50,000 – 30,000)		157,600	1
		509,119	
Current assets			
Inventories	373,600		½
Trade and other receivables	51,000		
Cash and cash equivalents	21,500		
		446,100	
Total assets		955,219	
Equity			
Ordinary share capital	302,000		
Share premium	180,000		
Retained earnings (SCE)	229,770		
Equity		711,770	
Non-current liabilities			
Provisions (25,000 / 1.07^{10})		12,709	1
Current liabilities			
Trade and other payables (193,700 – 1,160 (W2))	192,540		½
Taxation	38,200		½
		230,740	
Total equity and liabilities		955,219	

		Marks
Income statement for the year ended 31 March 2012		+ 1 pres
	£	
Revenue	3,973,000	½
Cost of sales (W1)	(2,140,700)	
Gross profit	1,832,300	
Administrative expenses (W1)	(1,363,240)	
Other operating costs (W1)	(249,140)	
Profit before tax	219,920	
Income tax (38,200 – 2,500)	(35,700)	1
Net profit for the period	184,220	

Note: Marks will be awarded if items are included in a different line item in the income statement provided that the heading used is appropriate.

Statement of changes in equity for the year ended 31 March 2012 (extract)		+ ½ pres
	Retained earnings £	
At 1 April 2011 (260,910 – 133,160)	127,750	½
Correction of error	(21,800)	½
Restated balance	105,950	½ (restated)
Total comprehensive income for year	184,220	
Dividend on ordinary shares (302,000 x 20p)	(60,400)	½
At 31 March 2012	229,770	

W1 Expenses

	Cost of sales	**Other operating costs**	**Admin expenses**	
Opening balance	2,220,900	195,300	1,363,240	½ b/fwds
Opening inventories – adjustment	(21,800)			½
Closing inventories – adjustment (315,200 – 373,600)	(58,400)			½
Development costs *(any cost category)*		80,000		½
Provision discounting		(25,000)		½
Purchases – exchange difference adj (W2)		(1,160)		1
	2,140,700	249,140	1,363,240	

W2 Foreign exchange

	£	
Translation at 1 December 2011 (29,000 x 0.86)	24,940	½
Translation at 31 March 2012 (29,000 x 0.82)	(23,780)	½
	1,160	

Total possible marks	15½
Maximum full marks	15

Question 2

Overall marks for this question can be analysed as follows: **Total: 28**

General comments

Part (a) of this question requires candidates to explain the financial reporting treatment of four accounting issues, given in the scenario. The four issues cover revenue recognition, government grants, convertible bonds and the recognition of an intangible as part of the acquisition of a subsidiary.

Part (b) requires candidates to revise six figures extracted from the draft consolidated financial statements for the adjustments needed as a result of their answer to Part (a). Part (c) requires the calculation of basic earnings per share and Part (d) involves an explanation of any ethical issues arising from the scenario.

Avebury plc **(a) IFRS accounting treatment**	**Marks**
(1) Loyalty card scheme	
IAS 18 Revenue, sets out that revenue should not be recognised until the significant risks and rewards of ownership have transferred to the buyer. The loyalty card is more like a service than the transfer of goods and is discounted over three years, being the loyalty period.	½
Therefore, the stage of completion needs to be calculated. Assuming that the service is consumed on a straight-line basis over the three year period, only:	½ ½
£25 x 9,000 x (36 – 30)/36 = £37,500 of revenue should be recognised for the year ended 31 March 2012.	1 (calc)
Deferred income of £187,500 (225,000 – 37,500) should be recognised. This should be split between current £75,000 (£225,000 x 12/36) and non-current £112,500 (187,500 – 75,000)	½ 1
If more information had been provided as to how often the leisure facilities are used by the customers holding the loyalty cards this information should be used instead to calculate how much revenue should be recognised.	1
(2) Government grant	
This grant provides assistance for the purchase of a non-current asset. IAS 20 Accounting for Government Grants and Disclosure of Government Assistance requires that grants related to assets should be either set up as deferred income, or deducted from the carrying amount of the asset. Avebury plc has stated that it prefers to use the deferred income approach, the net effect on profit or loss of the two approaches is the same.	1 ½ ½
The benefit is released to profit or loss over a period of time. Such grants should not be credited upon receipt to profit, and so the accounting treatment adopted in the draft financial statements is incorrect.	1
Where grants are received in relation to a depreciating asset, under the deferred income approach, the release to profit or loss should take place over the same period during which the asset is depreciated, and in the same proportions.	1
Therefore, in this case, the release to profit or loss should take place over the estimated useful life of 10 years. As a full year's depreciation will have been charged in the year ended 31 March 2012, a full year's grant should be credited: £250,000 / 10yrs = £25,000.	½ ½
At 31 March 2012 £225,000 should therefore be transferred out of profit or loss and into deferred income, split between current £25,000 and non-current £200,000.	½ 1

(3) Convertible bonds	
The convertible bonds are compound financial instruments per IAS 32 Financial instruments: Presentation and have both an equity and a liability component which should be presented separately at the time of issue. IAS 32 requires that the substance of the transaction be reflected, focusing on the economic reality that in effect two financial instruments have been issued.	1 ½
The liability component should be measured first at the present value of the capital and interest payments. The discount rate used should be the effective rate for an instrument with the same terms and conditions except for the ability to convert to shares.	1

	Cash flow £	DF @ 11%	PV £	
31 March 2012	140,000	1/1.11	126,126	½
31 March 2013	140,000	$1/1.11^2$	113,627	½
31 March 2014	2,140,000	$1/1.11^3$	1,564,750	½
Liability component			1,804,503	
Equity component (Bal fig)			195,497	½
Total			2,000,000	

The liability should be measured at £1,804,503 and the equity component should be calculated as the residual amount and measured at £195,497	½
The equity element will remain unchanged.	½
An adjustment is required as follows:	

Dr Non-current liability	£195,497
Cr Equity	£195,497

The interest expense should be calculated at 11% of the liability component.

1 Apr 2011 £	Interest (11%) £	Payment (7%) £	31 Mar 2012 £	
1,804,503	198,495	(140,000)	1,862,998	1

An adjustment is required to finance costs of £58,495 (198,495 – 140,000), as follows:	½

Dr Interest expense	£58,495
Cr Liability	£58,495

(4) Brand – acquisition of subsidiary	
An internally generated brand cannot be recognised under IAS 38 Intangible Assets as the costs cannot be identified separately from the cost of developing the business as a whole. Therefore, Silbury Ltd was correct not to recognise the brand.	1 ½
However, on the acquisition of a subsidiary (Silbury Ltd) IAS 38 assumes that an intangible asset, such as the brand, would normally be recognised separately as it would meet the recognition criteria of IAS 38. The issue would be whether a reliable value could be placed on the brand. In this instance it has been estimated that it has a market value of £240,000 and therefore the brand should be separately recognised from the goodwill arising on the acquisition.	½ ½ ½
Therefore, the brand should be separately recognised at £240,000 and amortised over its useful life of 12 years, being £20,000 (£240,000 / 12yrs) in the current year. Goodwill arising on the acquisition will decrease as a result of the separate recognition of the brand.	½ ½ ½
The carrying amount at 31 March 2012 is therefore £220,000 (240,000 – 20,000)	½
The following adjustments are required: Dr Intangible – brand £220,000 Dr Profit or loss £20,000 Cr Goodwill £240,000	
Total possible marks Maximum full marks	23½ 17

(b) Revised extracts from the consolidated financial statements	Profit after tax	Non-current assets	Equity	Current liabilities	Non-current liabilities	Marks
In draft financial statements	978,600	1,890,000	790,560	147,000	700,000	
(1) Loyalty card scheme						
Deferred revenue	(187,000)			75,000	112,500	1
(2) Government grant						
Transfer to deferred income	(225,000)			25,000	200,000	1
(3) Convertible bond						
Split liability vs equity			195,497		(195,497)	1
Interest in year	(58,495)				58,495	1
(4) Brand recognition						
Amortisation	(20,000)	(20,000)				1
Adjustment to retained Earnings (978,600 – 487,605)			(490,995)			½
In adjusted financial Statements	487,605	1,870,000	495,062	247,000	875,498	
Total possible marks Maximum full marks						5½ 5

(c) Basic earnings per share					**Marks**
Profit attributable to ordinary shareholders of Avebury plc	487,605				
Weighted average number of shares outstanding during the period need to take into account the effect of the bonus issue and the issue at market value, as follows:					
	No of shares	**Period in issue**	**Bonus factor**	**Weighted average**	
1 Apr – 31 Aug 2011	250,000	5/12	6/5	125,000	1
Issue at market price	50,000				
1 Sept – 31 Dec 2011	300,000	4/12	6/5	120,000	1
Bonus issue – 1 Jan 2012 (300,000 / 5)	60,000				
1 Jan – 31 Mar 2012	360,000	3/12	–	90,000	1
				335,000	
Basic EPS (487,605 / 335,000) = 146p					½ (OFs)
Total possible marks					3½
Maximum full marks					3

(d) Ethical issues	**Marks**
Yena appears to be influenced by the need to maintain the EPS at above 250p per share in order to gain staff bonuses thereby calling her integrity into question.	½
Basic EPS before the adjustments was 292p (978,600 / 335,000), which was comfortably above the 250p threshold. However, after adjustments it was considerably lower at 146p.	1
The professional competence of Yena also needs to be questioned as although she may have acted unethically she may alternatively have made a number of errors. Chartered accountants have an obligation to maintain their continuing professional development and they should ensure that their technical knowledge and professional skills are kept up to date.	1
Yena also has a self-interest threat as she is applying for a new job which may influence her actions in the short term.	½
Noku faces a number of ethical issues, not least the question of whether the mistakes were deliberate or a lack of knowledge on Yena's part. Noku also faces a self-interest threat as she also will gain a bonus if the EPS threshold is met and she may get a promotion with Yena's help.	1
Noku should ignore the possibility of self-interest and discuss the adjustments with Yena and remind her of her professional responsibilities to ensure that accounting standards are correctly followed.	½
Amendments must be made to the consolidated financial statements and if Yena refuses to make them, Noku must discuss the matter with the other board members.	½
If Yena continued to try to dominate and exert influence on Noku to misstate the consolidated financial statements then it would be appropriate for Noku to consult the ICAEW ethical handbook and discuss the matter with the ICAEW confidential helpline.	½
Total possible marks	5½
Maximum full marks	3

Question 3

Overall marks for this question can be analysed as follows: **Total: 31**

General comments

This question is a single topic question on non-current assets. In Part (a) candidates are required to prepare a number of extracts from the consolidated financial statements including the statement of cash flows. Candidates are required to consider the financial reporting treatment of revalued property, the costs that can be capitalised as part of property, plant and equipment including borrowing costs, a finance lease for land and buildings, impairment and the treatment of an associated undertaking. Part (b) features UK GAAP differences and Part (c) requires candidates to explain the usefulness and limitations of historical cost accounting.

Witan Ltd			**Marks**
(a) Consolidated income statement for the year ended 31 March 2012 (memorandum)			
Operating expenses			
Depreciation (55,000 (W1) + 1,440 (W2) + 47,400 (W3) + 19,400 (W4))	123,240		½ (add)
Management costs	72,000		½
Impairment	30,500		½
Repair costs	10,000		½
Building lease adjustment	(49,120)		½
Share of associate (W5)	9,350		½
Finance charge ((W5) + (400,000 x 6% x 2/12))	47,650		1½
Total impact on profit / (loss) for the period	243,620		
Consolidated statement of financial position as at 31 March 2012 (extracts)			½ Pres
Non-current assets		**£**	
Property, plant and equipment ((2,620,000 – 55,000) (W1) + 430,560 (W2) + 175,725 (W4) + 853,600)		4,024,885	
Investment in associate (W5)		64,600	½
Current liabilities			
Finance lease		5,743	
			½
Non-current liabilities			
Finance lease		861,787	
Equity			
Revaluation surplus (670,000 – 13,750) (W1)		656,250	½
Retained earnings (390,800 – 243,620 (as above) + 13,750)		160,930	1
Consolidated statement of cash flows for the year ended 31 March 2012 (extracts)		**£**	+ 1 pres
Cash flows from operating activities			
Interest paid		(43,650)	½ (OF)
Cash flows from investing activities			
Acquisition of associate		(57,000)	½
Dividend received from associate (20,000 x 35%)		7,000	½
Cash flows from financing activities			
Payment of finance lease liabilities (49,120 – 43,650)		(5,470)	1

Workings

(1) Revaluation surplus – Land and buildings

	£		
Valuation at 1 April 2011 (420,000 + 2,200,000)	2,620,000		½
Carrying amount at 1 April 2011 (300,000 + 1,750,000 – 100,000)	(1,950,000)		½
	670,000		
Less: Transfer to retained earnings			
Depreciation based on revalued amount (2,200,000 / 40yrs)	55,000		½
Depreciation based on historic cost (1,750,000 – 100,000) / 40 yrs	(41,250)		½
	13,750		

(2) New building

	£	
Architects fees	23,000	(½ for any 2) 1
Legal costs	7,000	
Project management fees	30,000	
Building costs	375,000	
Borrowing costs (W)	12,000	½
	447,000	
Less: lift cost	(15,000)	½
As at 1 February 2012	432,000	
Depreciation ((432,000 / 50yrs) x 2/12)	(1,440)	1
Carrying amount of new building	430,560	

Working:	£	
Borrowing costs (400,000 x 6% x 10/12)	20,000	1
Less: Investment income	(8,000)	½
	12,000	

(3) Impaired plant

	£	
Cost 1 April 2009	100,000	½
Depreciation to 31 March 2012 ((100,000 / 8 yrs) x 3yrs)	(37,500)	1
Carrying amount at 31 March 2012	62,500	
Recoverable amount (value in use)	(32,000)	½
Impairment	30,500	

(4) Plant and machinery

	£	£	
Plant & machinery b/fwd		331,000	
Lift		15,000	½
Less: accumulated depreciation		(92,375)	
		253,625	
Depreciation charge ((331,000 – 100,000) x 15%)	(34,650)		1
Depreciation charge re lift (15,000 / 10yrs) x 2/12)	(250)		1
Depreciation charge re impaired plant (100,000 / 8yrs)	(12,500)		½
		(47,400)	
Impairment (W3)		(30,500)	½
Carrying amount of plant & machinery		175,725	

	Marks
(5) Land & building lease	
Buildings – lease payment (61,400 x 80%) = £49,120 Land – lease payment (61,400 – 49,120) = £12,280	½

	B/fwd	Interest 5%	Payment	C/fwd	
	£	£	£	£	
31 Mar 2012	873,000	43,650	(49,120)	867,530	2
31 Mar 2013	867,530	43,377	(49,120)	861,787	

Depreciation (873,000 / 45yrs)	£19,400	½
Carrying amount (873,000 – 19,400)	£853,600	

(6) Associate (Chaffron Ltd)

Investment in associate

	£	
Cost of investment	57,000	½
Share of post-acquisition increase in net assets (35% x (56,000 – 20,000))	12,600	½
Less: Impairment	(5,000)	½
	64,600	

Share of profit of associate

	£	
Share of profit for the year (35% x (56,000)	19,600	½
Less: Share of PURP (35% x 15,000)	(5,250)	½
Less: Impairment	(5,000)	½
	9,350	

Total possible marks	29
Maximum full marks	24

(b) UK GAAP differences	**Marks**
Revaluation FRS 15 Tangible Fixed Assets, is based around using the current value model and therefore uses an existing use value for revaluations.	½
IAS 16 Property, Plant and Equipment, states that valuations should be to fair value, which would normally be a market value. This would generally be higher as it takes into account other uses for the asset.	½
FRS 15 specifies a maximum period of five years between full valuations and an interim valuation every three years.	½
IAS 16 does not specify a maximum period, instead the timing of revaluations depends on changes in market values.	½
Borrowing costs Under UK GAAP, FRS 15 allows a choice of whether borrowing costs are capitalised or expensed.	½
If borrowing costs are capitalised they are limited to the finance costs incurred on the eligible expenditure.	½
Under IAS 23 Borrowing Costs, the amount capitalised is limited to the borrowing costs on the total related funds less investment income from any temporary investment of those funds.	½

Land and building lease	
IAS 17 Leases, specifically requires a lease which covers both land and buildings to be split at inception into two leases, one for the land and one for the buildings. A lease for land will normally be an operating lease since the land will normally have an indefinite life.	½ ½
Under UK GAAP there is no requirement to split a lease which covers both land and buildings. Such a lease will therefore normally be recognised as an operating lease.	½ ½
Total possible marks Maximum full marks	5½ 4

(c) Historic cost	**Marks**
Usefulness of historic cost	
• Historical cost is a known amount, it is a reliable measurement – there is no subjectivity involved unlike the revaluation model where a great deal of judgement is involved.	½
• There is no cost involved in valuing historical cost as it is the amount that was paid. Measuring fair value can be extremely costly depending on the nature of the asset.	½ ½
• Other measurement bases can be subject to manipulation, as valuation techniques need to be applied.	
Limitations of historical cost	
• By its very definition it is an historical amount and therefore does not reflect the true value that the asset may be worth unlike revalued amounts which are current at the time of the valuation. An asset held at a revalued amount is more relevant information for users. For example, property prices generally increase over time, so a property acquired a number of years ago will be shown in the financial statements at a value significantly less than its true value to the business.	½ ½ ½
• Historical cost also ignores the effects of inflation	½
Total possible marks Maximum full marks	3½ 3

Question 4

Overall marks for this question can be analysed as follows: **Total: 26**

General comments
This question requires the preparation of a consolidated statement of financial position. The group had one subsidiary and a joint venture entity. A fair value adjustment needed to be made in respect of a non-current asset that had a fair value in excess of its carrying amount in the subsidiary. Inter-company trading in respect of an item of PPE and inventory had taken place during the year.

Part b) requires candidates to explain the principles behind the use of equity accounting for joint venture entities.

Tongwell plc

(a) Consolidated statement of financial position as at 31 March 2012

	£	£	Marks
			Pres 1
Assets			
Non-current assets			
Property, plant and equipment (660,700 + 635,300 + 24,000 (W1) – 1,000 (W1) – 3,000 (W7))		1,316,000	1½ (OFs)
Intangibles (101,300 + 144,475 (W2))		245,775	½
Investment in joint venture (W6)		93,600	
		1,655,375	
Current assets			
Inventories (235,400 + 195,900 – 2,400)	428,900		1 (+ PPE)
Trade and other receivables (174,900 + 78,800 – 50,000)	203,700		½
Cash and cash equivalents (23,700 + 11,900 + 10,000)	45,600		1 (+ TRs)
		678,200	
Total assets		2,333,575	
Equity and liabilities			
Equity attributable to owners of Shiraz plc			
Ordinary share capital		100,000	½
Revaluation surplus		125,000	½
Retained earnings (W4)		1,099,550	
		1,324,550	
Non-controlling interest (W3)		190,025	
Total equity		1,514,575	
Current liabilities			
Trade and other payables (151,200 + 101,800 – 40,000)	213,000		½
Taxation (85,000 + 80,000)	165,000		½ (+TPs)
Deferred consideration	441,000		½
		819,000	
Total equity and liabilities		2,333,575	

Workings

(1) Net assets – Watling Ltd

	Year end £	Acquisition £	Post acq £	
Share capital	500,000	500,000	-	½
Retained earnings				
Per Q	312,100	206,700		
Less: Intangible (72,000 + 18,000)	(72,000)	(90,000)		1
Fair value adj re PPE (120,000 – (92,000 x 48/46))	24,000	24,000		1
Dep thereon (24,000 x 2/48)	(1,000)	-		½ (OF)
PPE PURP (W7)	(3,000)	-		½ (OF)
	760,100	640,700	119,400	

(2) Goodwill – Watling Ltd

	£	
Consideration transferred (250,000 + (441,000 – 41,000 (W4))	650,000	½ + 1
Non-controlling interest at acquisition (640,700 (W1) x 25%)	160,175	½ (OF) for both
Net assets at acquisition (W1)	(640,700)	
	169,475	
Impairment to date	(25,000)	½
	144,475	

(3) Non-controlling interest – Watling Ltd

	£	
Non-controlling interest at acquisiton	160,175	
Share of post acquisition reserves (119,400 (W1) x 25%)	29,850	
	190,025	½ (OF)

(4) Retained earnings

	£	
Tongwell plc	1,084,800	
Unwinding of discount – deferred consideration (441,000 – (441,000 / 1.05^2))	(41,000)	1
Less: PURP (Merlot Ltd) (W5)	(2,400)	½ (OF)
Watling Ltd (119,400 (W1) x 75%)	89,550	½ (OF)
Groveway Ltd (W6)	3,600	½ (OF)
Less: Impairments to date (25,000 + 10,000)	(35,000)	½
	1,099,550	

(5) Inventory PURPs

	%	Groveway Ltd £	Watling Ltd £	
SP	100	15,000	12,000	
Cost	(80)	(12,000)	(9,600)	
GP	20	3,000	2,400	½ +½

(6) Investment in joint venture – Groveway Ltd

	£	£	
Cost		100,000	½ Ab
Add: Post acquisition profits	12,000		½ Ab
Less: PURP (W5)	(3,000)		½ (OF)
	9,000		
x 40%		3,600	½ x OF
		103,600	
Less: Impairment to date		(10,000)	½
		93,600	

(7) PPE PURP – Watling Ltd		
	£	
Asset now in Tongwell plc's books at 15,000 x 1/3	5,000	½
Asset would have been in Watling Ltd's books at 10,000 x 1/5	(2,000)	½
	3,000	
Total possible marks		22
Maximum full marks		20

(b) Goodwill journal entries			**Marks**
Dr: Intangibles – goodwill	39,160		½
Dr: Share capital	320,000		½
Dr: Retained earnings	112,300		½
Cr: Investments		385,000	½
Cr: Non-controlling interest (320,000 + 112,300) x 20%		86,460	½
Total possible marks			2½
Maximum full marks			2

(c) Use of equity method of accounting for jointly controlled entities	**Marks**
The equity method of accounting is also used for associates and recognises that the parent has "significant influence", but not control, over the associate. This is a similar situation to a jointly controlled entity, where there is joint (but not overall) control or significant influence.	½ ½
Because the parent, in both cases (for an associate or for a jointly controlled entity), does not have overall control, then complete consolidation would be misleading. Therefore the equity method of accounting is used as it is a method that accounts for an entity's interest in the net assets of an investee by:	½ ½
• recording the investment initially at cost, then	½
• adjusting cost each period for the venturer's share of the retained profits or losses of the jointly controlled entity for the current period, such that	½
• in the consolidated statement of financial position the investment in the jointly controlled entity is shown as a single line figure as part of non-current assets, and	½
• in the consolidated income statement there is a single line for the venturer's share of the jointly controlled entity's results for that period.	½
Goodwill is subsumed within the carrying amount of the jointly controlled entity in the consolidated statement of financial position, and the total investment tested for impairment annually.	½ ½
It could be argued that proportional consolidation is more appropriate for jointly controlled entities as joint control is more than "significant influence". However, others would argue that it is inappropriate to combine controlled items (ie where assets and liabilities for subsidiaries are included at 100% on a line-by-line basis, with the disclosure of a subsequent figure for non-controlling interest) with jointly controlled items (ie where, under proportional consolidation, the venturer's *share* of the entity's assets and liabilities would be included on a line-by-line basis).	½ ½ ½
Total possible marks	6½
Maximum full marks	4

PROFESSIONAL LEVEL EXAMINATION

SAMPLE PAPER

(3 hours)

FINANCIAL ACCOUNTING AND REPORTING

This paper consists of **FOUR** written test questions (100 marks).

1. Ensure your candidate details are on the front of your answer booklet.
2. Answer each question in black ball point pen only.
3. Answers to each written test question must begin on a new page and must be clearly numbered. Use both sides of the paper in your answer booklet.
4. The examiner will take account of the way in which answers are presented.

Unless otherwise stated, make all calculations to the nearest month and the nearest £.

All references to IFRS are to International Financial Reporting Standards and International Accounting Standards.

IMPORTANT Question papers contain confidential information and must NOT be removed from the examination hall. **DO NOT TURN OVER UNTIL YOU ARE INSTRUCTED TO BEGIN WORK**	You MUST enter your candidate number in this box. [ ][ ][ ][ ]

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1. Portway Ltd is a retailer of outdoor leisure products. Yakini, the financial controller, has started to produce the financial statements for the year ended 31 March 2012 from the company's nominal ledger. However, there are a number of issues outstanding. The draft financial statements, as prepared by Yakini, are set out below.

Draft statement of financial position as at 31 March 2012

	£	£
ASSETS		
Non-current assets		
Property, plant and equipment		338,810
Intangibles (Note 1)		237,600
		576,410
Current assets		
Inventories (Note 2)	315,200	
Trade and other receivables	51,000	
Cash and cash equivalents	21,500	
		387,700
Total assets		**964,110**
EQUITY AND LIABILITIES		
Equity		
Ordinary share capital (£1 shares)		302,000
Share premium		180,000
Retained earnings		260,910
		742,910
Current liabilities		
Trade and other payables	193,700	
Provision (Note 4)	25,000	
Taxation (Note 6)	2,500	
		221,200
Total equity and liabilities		**964,110**

Draft income statement for the year ended 31 March 2012

	£
Revenue	3,973,000
Cost of sales	(2,220,900)
Gross profit	1,752,100
Administrative expenses	(1,363,240)
Other operating costs	(195,300)
Operating profit	193,560
Finance costs (Note 6)	(60,400)
Profit before tax	133,160

The following additional information is available:

(1) Portway Ltd undertook some research and development in the year in respect of rain proof material. The costs have been capitalised above and represent the total balance included in intangibles. £50,000 of these costs were incurred prior to 1 January 2012, the date on which the costs met the criteria for recognition as an intangible asset. Also included is £30,000 that was incurred on an advertising campaign and which it is estimated will generate an additional £300,000 of revenue over a two year period. The material was in its final stages of development at 31 March 2012 and the recoverable amount was estimated at £200,000.

(2) The warehouse supervisor was late finalising the inventories figure for 31 March 2012 so when preparing the draft financial statements above Yakini assumed that closing inventory was exactly the same as the opening inventory brought forward from last year's financial statements. Closing inventory has now been finalised at £373,600, including the goods purchased from overseas referred to in Note (3) below. However, when preparing this figure the warehouse supervisor identified that there had been a computation error in the final inventory figure at 31 March 2011 which resulted in it being overstated by £21,800.

(3) Portway Ltd purchased some inventories from an overseas supplier on 1 December 2011 for €29,000. The invoice was unpaid at 31 March 2012 as an extended credit period of six months was given to Portway Ltd as a new customer. Yakini recognised this transaction correctly on 1 December 2011.

The spot exchange rates are as follows:

1 December 2011 – €1:£0.86
31 March 2012 – €1:£0.82

(4) The provision recognised above, and included in other operating costs, is for dismantling one of Portway Ltd's retail units and returning the site to its original condition. This was a condition put in place by the local government authority when the unit was constructed. The unit was completed on 31 March 2012 and will need to be removed in ten years' time. The estimated cost (today) of dismantling the unit in 10 years' time is £25,000.

(5) Yakini was waiting for the current year tax liability to be calculated by one of her colleagues, which is why she did not include it in the above draft financial statements. It has now been finalised at £38,200. There was an over-provision last year with the final amount paid being £2,500 lower than the amount provided for in the financial statements for the year ended 31 March 2011. Yakini has left the balance of tax overprovided in current liabilities.

(6) An ordinary dividend was paid on 1 January 2012 at 20p per share. Yakini wasn't sure where to record this dividend so she included it in finance costs.

Portway Ltd uses a discount rate of 7% pa where necessary to reflect the time value of money in the preparation of the financial statements.

Requirements

Prepare:

(i) a revised income statement for Portway Ltd for the year ended 31 March 2012 and a revised statement of financial position as at that date in a form suitable for publication; and

(ii) an extract from the statement of changes in equity for the year ended 31 March 2012 showing the retained earnings column only.

(15 marks)

NOTES: Notes to the financial statements are not required.

2. Avebury plc is listed in the UK and provides leisure facilities. Draft consolidated financial statements have been prepared for the year ended 31 March 2012. The finance director, Yena, has asked her deputy, Noku, to make any adjustments required to complete the financial statements in respect of a few outstanding issues. Both Yena and Noku are chartered accountants.

Yena told Noku: "As you know, the year-end profit figure is of critical importance. In order to retain the confidence of shareholders and lenders we need to report as high a profit as possible. You also need to remember that if we maintain our basic earnings per share above 250p we will all get a bonus.

I'm leaving the company for a new job in four weeks' time, so if you do a good job on the consolidated financial statements I'll put in a good word for you, as I'm sure you'd make a great replacement for me. Please calculate the effects of the final adjustments on the consolidated financial statements and also calculate basic earnings per share."

The following information has been extracted from the draft consolidated financial statements:

	£
Profit after taxation	978,600
Non-current assets	1,890,000
Equity	790,560
Current liabilities	147,000
Non-current liabilities	700,000

The following outstanding issues have been identified:

(1) Avebury plc introduced a loyalty card scheme for its customers in July 2011. Customers pay £25 each for the cards and they claim a 20% discount on all future use of Avebury plc's leisure facilities for three years from the date of purchasing the card. By 31 March 2012 Avebury plc had issued 9,000 loyalty cards, which have an average unexpired period of 30 months. Yena has credited the income statement for the year ended 31 March 2012 with £225,000 in respect of the sale of these cards.

(2) On 1 April 2011 Avebury plc opened a new leisure complex which is subject to straight-line depreciation over its estimated useful life of 10 years. Avebury plc selected a location, in an economically deprived area, because of the availability of government grants to assist with the cost of the building. A grant of £250,000 was received in May 2011, and was credited to other income. Avebury plc's stated accounting policy is to use the deferred income approach.

(3) On 1 April 2011 Avebury plc issued 200,000 7% £10 convertible bonds at par. The bonds can be redeemed on 31 March 2014 for ordinary shares converted at the rate of five ordinary shares for each £10 bond.

The proceeds of the issue have been credited to non-current liabilities. The interest is payable annually in arrears and £140,000 has been accrued in finance costs. The equivalent effective interest rate on similar bonds without conversion rights is 11% pa.

(4) On 1 April 2011 Avebury plc acquired all of the share capital of Silbury Ltd. Yena has correctly consolidated the net assets and results for Silbury Ltd in the draft consolidated financial statements. Goodwill of £420,000 was recognised in respect of the acquisition.

However, on further investigation Yena has now discovered that Silbury Ltd has a brand that was not recognised in its own financial statements and wondered whether the brand should have been recognised. An external consultant valued the brand at £240,000 on 1 April 2011 and it is thought to have a useful life of 12 years.

On 1 April 2011 Avebury plc had in issue 250,000 £1 ordinary shares. On 1 September 2011 Avebury plc issued, for cash, 50,000 £1 ordinary shares for full market value of 105p per share. A 1 for 5 bonus issue was then made on 1 January 2012. These share transactions have been correctly reflected in the draft consolidated financial statements.

Requirements

(a) Explain the required IFRS accounting treatment of the four issues above, preparing all relevant calculations and setting out the required adjustments. **(17 marks)**

(b) Using your results from part (a) calculate revised extracts from the draft consolidated financial statements for the year ended 31 March 2012. **(5 marks)**

(c) Calculate basic earnings per share for the year ended 31 March 2012. **(3 marks)**

(d) Identify and explain any ethical issues arising for Yena and Noku and any action that Noku should take. **(3 marks)**

(28 marks)

NOTES: Ignore the impact of taxation on the above issues.
The preparation of disclosure notes is not required.

3. During the year-ended 31 March 2012 Witan Ltd entered into a number of transactions relating to non-current assets. The financial controller is preparing the draft consolidated financial statements and is unsure how to treat these transactions. Prior to dealing with these transactions, draft consolidated retained earnings were £390,800 as at 31 March 2012.

Information relating to the non-current assets as at 1 April 2011 is set out below.

	Cost	Accumulated depreciation	Valuation
	£	£	£
Land	300,000	-	420,000
Buildings	1,750,000	100,000	2,200,000
Plant and machinery	331,000	92,375	-

(1) Witan Ltd has previously adopted the cost model for all its property, plant and equipment. However, on 1 April 2011 the directors decided to revalue the land and buildings to the amounts shown above.

The buildings were originally being depreciated over 50 years but at the date of valuation it was determined that the remaining useful life was 40 years. Witan Ltd wishes to make an annual transfer between the revaluation surplus and retained earnings.

(2) A new building, Eaglestone, was constructed on a site that Witan Ltd has owned for a number of years. Construction commenced on 1 April 2011 and total building costs incurred during the year were:

	£
Architect's fees	23,000
Legal costs	7,000
Project management fees	30,000
Building costs	375,000
Management costs	72,000

Project management fees represent amounts paid to an independent project management company whereas management costs are internal administration costs reallocated to the project. Included in the building costs is the cost of buying and installing a goods lift. The total cost of the lift was £15,000 and it was thought that it would need replacing every ten years. The lift should be classified as plant and machinery.

The building was completed on 31 December 2011, was ready for use on 1 February 2012 and has a useful life of 50 years. On 1 April 2011 Witan Ltd borrowed £400,000 at an interest rate of 6% pa to fund the construction and up to 31 March 2012 had earned £8,000 of investment income from the temporary investment of unused funds. Witan Ltd has met the conditions to apply IAS 23 Borrowing Costs.

(3) During January 2012 one of Witan Ltd's major pieces of plant developed a substantial fault and rectification work was carried out at a cost of £10,000. The accounting entry made at the time of the payment was to debit a suspense account until the correct accounting treatment could be determined.

This plant, which is included in plant and machinery above, had cost £100,000 on 1 April 2009 and is being depreciated straight-line over eight years. At 31 March 2012 the plant was assessed as having a fair value of £30,000, with costs to sell at £3,000. Its value in use has been estimated at £32,000.

Depreciation is charged on the remaining plant and machinery at a rate of 15% pa straight line.

(4) Witan Ltd entered into a 45 year lease for land and buildings on 1 April 2011. The buildings had an estimated useful life of 50 years. The fair value of the leasehold interest is £1,100,000 of which 20% relates to land. The present value of the minimum lease payments in respect of the buildings is £873,000 and the interest rate implicit in the lease is 5% pa. The total annual lease payment is £61,400 commencing on 31 March 2012.

Witan Ltd dealt with this transaction by including the £61,400 lease payment made on 31 March 2012 in operating expenses. No other accounting entries were made.

(5) On 1 April 2011 Witan Ltd purchased 35% of the 200,000 ordinary shares in Chaffron Ltd for cash of £57,000. Witan Ltd has significant influence over Chaffron Ltd. In the year ended 31 March 2012 Chaffron Ltd:

- made a profit after tax of £56,000
- paid ordinary dividends of £20,000, and
- sold goods to Witan Ltd for a profit of £15,000. These goods were still held by Witan Ltd on 31 March 2012.

Witan Ltd recognised its investment in Chaffron Ltd at cost and the dividend received has been credited to a suspense account. An impairment in the value of Chaffron Ltd of £5,000 needs to be recognised in the consolidated financial statements.

Requirements

(a) (i) Prepare extracts from Witan Ltd's consolidated statement of financial position as at 31 March 2012 and a summary of the related costs that would be recognised in the consolidated income statement for the year ended 31 March 2012 in respect of **all** the issues above.

(ii) In respect of issues (4) and (5) **only** prepare extracts from Witan Ltd's consolidated statement of cash flows for the year ended 31 March 2012.

(24 marks)

NOTE: Notes to the financial statements are not required.
No written explanation of the IFRS accounting treatment is required.

(b) Explain any differences between IFRS and UK GAAP in respect of the financial reporting treatment of all the above issues. **(4 marks)**

(c) Historical cost is one of the four measurement bases referred to in the Conceptual Framework. Explain the usefulness and limitations of measuring non-current assets using the historical cost model compared to the revaluation model under IAS 16 Property, plant and Equipment. **(3 marks)**

(31 marks)

4. Tongwell plc has investments in two companies, Watling Ltd and Groveway Ltd. The draft summarised statements of financial position of the three companies at 31 March 2012 are shown below:

	Tongwell plc	Watling Ltd	Groveway Ltd
	£	£	£
ASSETS			
Non-current assets			
Property, plant and equipment	660,700	635,300	261,600
Intangibles	101,300	72,000	–
Investments	350,000	–	–
	1,112,000	707,300	261,600
Current assets			
Inventories	235,400	195,900	65,700
Trade and other receivables	174,900	78,800	56,600
Cash and cash equivalents	23,700	11,900	3,400
	434,000	286,600	125,700
Total assets	**1,546,000**	**993,900**	**387,300**
EQUITY AND LIABILITIES			
Equity			
Ordinary share capital (£1 shares)	100,000	500,000	200,000
Revaluation surplus	125,000	–	–
Retained earnings	1,084,800	312,100	12,000
	1,309,800	812,100	212,000
Current liabilities			
Trade and other payables	151,200	101,800	137,400
Taxation	85,000	80,000	37,900
	236,200	181,800	175,300
Total equity and liabilities	**1,546,000**	**993,900**	**387,300**

Additional information:

(1) Tongwell plc acquired 75% of Watling Ltd's ordinary shares on 1 April 2010 for total cash consideration of £691,000. £250,000 was payable on the acquisition date and the remaining £441,000 two years later, on 1 April 2012. The directors of Tongwell plc were unsure how to treat the deferred consideration and have ignored it when preparing the draft financial statements above.

On the date of acquisition Watling Ltd's retained earnings were £206,700. Tongwell plc chose to measure the non-controlling interest at the acquisition date at the non-controlling interest's share of Watling Ltd's net assets.

(2) The intangible asset in Watling Ltd's statement of financial position relates to goodwill which arose on the acquisition of an unincorporated business, immediately prior to Tongwell plc purchasing its shares in Watling Ltd. Cumulative impairments of £18,000 in relation to this goodwill had been recognised by Watling Ltd as at 31 March 2012.

The fair values of the remaining assets, liabilities and contingent liabilities of Watling Ltd at the date of their acquisition by Tongwell plc were equal to their carrying amounts, with the exception of a building purchased on 1 April 2008, which had a fair value on the date of acquisition of £120,000. This building is being depreciated by Watling Ltd on a straight-line basis over 50 years and is included in the above statement of financial position at a carrying amount of £92,000.

(3) Immediately after its acquisition by Tongwell plc, Watling Ltd sold a machine to Tongwell plc. The machine had been purchased by Watling Ltd on 1 April 2008 for £10,000 and was sold to Tongwell plc for £15,000. The machine was originally assessed as having a total useful life of five years and that estimate has never changed.

(4) Groveway Ltd is a jointly controlled entity, set up by Tongwell plc and a fellow venturer on 30 June 2010. Tongwell plc paid cash of £100,000 for its 40% share of Groveway Ltd and accounts for its interest in Groveway Ltd using the equity method of accounting.

(5) During the current year Tongwell plc sold goods to Watling Ltd for £12,000 and to Groveway Ltd for £15,000, earning a 20% gross margin on both sales. All of these goods were still in the purchasing companies' inventories at the year end.

(6) At 31 March 2012 Tongwell plc's trade receivables included £50,000 due from Watling Ltd. However, Watling Ltd's trade payables included only £40,000 due to Tongwell plc. The difference was due to cash in transit.

(7) At 31 March 2012 impairment losses of £25,000 and £10,000 respectively in respect of goodwill arising on the acquisition of Watling Ltd and the carrying amount of Groveway Ltd need to be recognised in the consolidated financial statements.

In the next financial year, Tongwell plc decided to invest in a third company, Arlott Ltd. On 1 December 2012 Tongwell plc acquired 80% of Arlott Ltd's ordinary shares for £385,000. On the date of acquisition Arlott Ltd's equity comprised share capital of £320,000 and retained earnings of £112,300. Tongwell plc chose to measure the non-controlling interest at the acquisition date at the non-controlling interest's share of Arlott Ltd's net assets. Goodwill arising on the acquisition of Arlott Ltd has been correctly calculated at £39,160 and will be recognised in the consolidated statement of financial position as at 31 March 2013.

An appropriate discount rate is 5% pa.

Requirements

(a) Prepare the consolidated statement of financial position of Tongwell plc as at 31 March 2012. **(20 marks)**

(b) Set out the journal entries that will be required on consolidation to recognise the goodwill arising on the acquisition of Arlott Ltd in the consolidated statement of financial position of Tongwell plc as at 31 March 2013. **(2 marks)**

(c) IAS 31, Interests in Joint Ventures, allows each venturer in a jointly controlled entity to recognise its share of that entity in its consolidated financial statements using either proportionate consolidation or the equity method of accounting. Identify and explain the principles behind the use of the equity method of accounting for jointly controlled entities in consolidated financial statements. **(4 marks)**

(26 marks)

MARK PLAN AND EXAMINER'S COMMENTARY

The mark plan set out below was that used to mark these questions. Markers are encouraged to use discretion and to award partial marks where a point was either not explained fully or made by implication. More marks are available than could be awarded for each requirement, where indicated. This allows credit to be given for a variety of valid points, which are made by candidates.

Question 1

Total marks: 30

Overall marks for this question can be analysed as follows**:**

General comments

This question presented a draft set of financial statements with some adjustments. Candidates were required to prepare the amended statement of profit or loss and statement of financial position. A number of adjustments were required to be made, including depreciation, revenue adjustments, provisions, treasury shares, a lease incentive and a prior year inventory adjustment.
Part b) required candidates to explain the concepts of accruals basis of accounting and going concern, with reference to the scenario.
Part c) required a discussion on the ethical issues arising from the scenario.

Coghlan Ltd – Statement of financial position as at 30 September 2014		
	£	**£**
ASSETS		
Non-current assets		
Property, plant and equipment (600,000 + 138,260) (W3)		738,260
Current assets		
Inventories	98,000	
Trade and other receivables	125,400	
Tax asset	65,000	
Cash and cash equivalents	1,200	
		289,600
Total assets		1,027,860
Equity		
Ordinary share capital (294,500 + 85,500)	380,000	
Share premium	94,000	
Treasury shares (45,000 x £1.90)	(85,500)	
Retained earnings (W4)	52,910	
Equity		441,410
Non-current liabilities		
Lease incentive		7,200
Current liabilities		
Trade and other payables	31,900	
Deferred income (36,000 x 3/12)	9,000	
Provision (W2)	538,350	
		579,250
Total equity and liabilities		1,027,860

Coghlan Ltd – Statement of profit or loss for the year ended 30 September 2014

	£
Revenue (3,359,200 – (36,000 x 3/12))	3,350,200
Cost of sales (W1)	(2,744,950)
Gross profit	605,250
Administrative expenses (W1)	(1,418,965)
Loss before tax	(813,715)
Income taxation (65,000 + 32,800)	97,800
Net profit for the period	(715,915)

W1 Expenses

	Cost of sales £	Administrative expenses £
Brought forward	2,198,050	1,039,700
Opening inventories adj (114,550 – 79,000)	(35,550)	
Closing inventories adj (142,100 – 98,000)	44,100	
Provision (W2)	538,350	
Lease incentive (1,200 x 6)		7,200
Impairment (W3)		293,750
Depreciation charge (43,750 + 34,565) (W3)		78,315
	2,744,950	1,418,965

W2 Provision

		£
Brought forward		500,000
Lawsuits (50 x 350)	17,500	
Warranties ((65,000 x 20%) + (157,000 x 5%))	20,850	
		38,350
At 30 September 2014		538,350

W3 Plant and equipment

	Land and buildings £	Fixtures and fittings £
Carrying amount at 1 Oct 2013 (1,125,000 – 187,500) / (236,000 – 63,175)	937,500	172,825
Depreciation charge for the year		
(1,125,000 – 250,000) x 5%	(43,750)	
172,825 x 20%		(34,565)
Carrying amount at 30 Sept 2014	893,750	138,260
Recoverable amount	600,000	170,000
Impairment	293,750	–

W4 Retained earnings

	£
Per draft	425,825
Add: draft loss	416,550
Less: revised profit and loss	(715,915)
Dividend paid (380,000 x 10p)	(38,000)
Prior year adjustment – inventories	(35,550)
	52,910

Presentation of the statement of profit or loss and statement of financial position was generally good. As indicated as acceptable at the tutor conference, most candidates omitted sub-totals on the statement of financial position, but were penalised if they omitted totals for total assets and total equity and liabilities. A minority missed out sub-totals on the statement of profit or loss – this is not considered acceptable and marks were lost for this. However, there were a number of very messy statements, usually the statement of profit or loss, where costs workings were shown on the face of the statement instead of in a recommended "costs matrix" in the workings. Whereas in most recent sittings almost all candidates have used a costs matrix, this was not the case at this sitting.

Performance on this question was good, with some high marks achieved. A significant number of candidates arrived at completely correct figures in respect of revenue, cost of sales, closing inventories and the provision. Most candidates also arrived at the correct figures for the two depreciation charges for the year, and correctly presented them in administrative expenses. However, a few candidates calculated depreciation based on the year end recoverable amounts instead of on the opening figures. It was also common to see the fixtures and fittings, which were not impaired, revalued, when no indication was given that the company wished to move to the revaluation model. Pleasingly, most candidates did provide relatively clear workings for their property, plant and equipment figure.

The tax refund probably caused the most difficulties, with only a few candidates treating both this and the over-provision from the previous year correctly. A number of candidates showed only the tax refund in the statement of profit or loss, others reduced the tax refund by the over-provision from the previous year, instead of adding it. Many were so confused by the income tax position that they showed no figure for income tax at all in the statement of profit or loss. On the statement of financial position it was common to see the over-provision from the previous year reducing the tax asset. And whatever figure was arrived at this was presented more often as a "negative" current liability than (correctly) as a current asset.

Other common errors included the following:

- Errors in adjusting cost of sales for the incorrect inventory valuations – most commonly getting the net adjustment in the wrong direction against the cost of sales figure from the draft financial statements, or making careless errors in the calculations.
- Calculating the dividend paid during the year on a figure other than the one shown in their own statement of financial position.

Total possible marks Maximum full marks	20½ 19

(b)

Accrual basis

The accrual basis of accounting records transactions in the period in which they occur, rather than when the cash inflow or outflow arises. Under the accrual basis an entity recognises items as assets, liabilities, equity, income and expenses when they satisfy the definition and recognition criteria for those elements in the Framework

An example of this is the treatment of the revenue generated from the magazine subscriptions. These were incorrectly recorded in revenue as the cash had been received, however part of the service delivery, ie the magazines being despatched, arose after the year end and therefore part of the revenue should have been deferred.

The recognition of the provisions are another example of the accrual basis, as these are present obligations arising from past events and hence have been recognised as liabilities in the current period, although the cash will be paid out in future periods.

Other examples include the charging of depreciation on the property, plant and equipment recognising that the entity is generating economic benefits from these assets over their useful lives and the charging of operating lease rental over the total period of the lease.

Going concern basis

The going concern basis of accounting assumes that the entity will continue operating in the foreseeable future as a going concern. To operate for the foreseeable future there must be no intention by management, or the need, to liquidate the entity by selling its assets and paying its liabilities.

The going concern basis affects the valuation of the company's assets. It is assumed that non-current assets, for example, will be used in the operation of the entity and therefore the use of historical cost is considered appropriate. However, if the entity ceases in operation then the historical cost basis would no longer be appropriate and instead the assets would be valued based on their recoverable amount at that point in time, this valuation basis is known as the break-up basis. The concept of being "non-current" also would no longer be appropriate as all assets and liabilities would be "current" in nature as the entity would no longer be trading.

Coghlan Ltd's financial statements have been prepared using the going concern basis of accounting. If the break-up basis were appropriate due to the company no longer being a going concern, as a result of the adverse publicity, caused by the unsafe products, assets and liabilities might be different. For example, Coghlan Ltd has five years left on the office lease, if Coghlan Ltd ceased to trade the lease would become an onerous obligation and the full amount would need to be recognised.

Coghlan Ltd traded at a large loss during the year, if this performance continues it is unlikely that the company would be a viable trading entity for long. In addition a dividend was paid, presumably to ensure shareholders remained happy, however as a result of this retained earnings and hence distributable profits are virtually zero, so no further dividends could be paid in the future without substantial profits being made. It is therefore questionable whether Coghlan Ltd will remain a going concern for much longer.

This part of the question was reasonably well answered although few candidates scored high marks. Most candidates could give a basic definition of the accruals concept, but the quality of explanation using the subscription revenue and the operating lease varied.

Again, most candidates could give a basic definition of the going concern concept, and cite the break-up basis as an alternative, but less candidates went beyond this to explain how going concern financial statements differ from those prepared on a break-up basis. However, a majority of candidates made the point that Coghlan Ltd appeared to be in financial difficulties and that therefore the going concern basis may not be appropriate.

Total possible marks	11
Maximum full marks	6

(c)

Professional accountants are expected to follow the guidance contained in the fundamental principles in all of their professional and business activities. The Code of Ethics has five fundamental principles.

The financial statements should be prepared fairly, honestly and in accordance with relevant professional standards.

Objectivity is one of the five fundamental principles in the ICAEW's ethical Code, which means that I should not allow bias, conflict of interest or undue influence of others to override professional or business judgements. I should not let the managing director pressure me into completing the financial statements quickly and not making a satisfactory and thorough job. Intimidation threat exists.

Professional behaviour is another principle and hence I should ensure that the relevant laws and regulations are complied with. I should ensure that I act with both professional competence and due care and therefore not be influenced by the pressure that management are putting on me. The financial statements should be prepared by someone who has the relevant expertise and that is unlikely to be someone who is undertaking work experience. I should not allow bias in any way, conflict of interest or undue influence of others override my professional judgement. It is unfair for the managing director to mention my performance appraisal and therefore I need to ensure that this does not affect any decisions I make as a self-interest threat exists.

I should explain that the financial statements need additional work to the managing director and explain that they may take longer than he would have ideally liked to ensure that they provide a fair assessment of the facts. If he is unwilling to allow additional time then I should discuss the matter with the other directors and explain that I am being pressured by the managing director. I should keep a record of all discussions and I could discuss the matter confidentially with the ICAEW helpline for advice and support.

The answers to the “ethics” part were mixed, with a significant number of candidates putting themselves in the position of being the external auditor, as opposed to the financial controller, as specified in the question. Most candidates identified self-interest and possible intimidation threats, that the financial controller should uphold the values of professional competence and due care and professional behaviour, and refer continuing difficulties with the managing director to the other directors and then to the ICAEW ethics helpline. Weaker candidates missed the point that all discussions should be documented and spent some time discussing the ethics of the managing director, when we were not told whether he was an ICAEW Chartered Accountant or not.

Total possible marks	8½
Maximum Marks	5

Question 2

Total marks: 36

Overall marks for this question can be analysed as follows**:**

General comments
Part (a) of this question required candidates to explain the financial reporting treatment of four accounting issues, given in the scenario. The four issues covered borrowing costs, a compound financial instrument, an intangible asset and a joint venture. Journal entries were also required.
Part (b) required candidates to recalculate consolidated profit for the year for the adjustments needed as a result of their answer to Part (a).
Part (c) required a calculation of basic earnings per share following a rights issue and explanation of the accounting treatment was also required.

Porcaro plc

(a) (i) IFRS accounting treatment

(1) Borrowing cost

Under IAS 23 Borrowing costs, certain borrowing costs form part of the cost of the qualifying asset, and should therefore be capitalised. A qualifying asset is an asset which takes a substantial period of time to get ready for its intended use, or sale. The office block is therefore a qualifying asset as it is not ready for use.

Borrowing costs are defined as interest and other costs that an entity incurs in connection with the borrowing of funds. Only borrowing costs that are directly attributable to the acquisition, construction or production of the qualifying asset should be capitalised. These are the borrowing costs which would have been avoided if the expenditure on the qualifying asset had not been incurred.

As the loan was specifically taken out for the purpose of funding the construction of the office block use the actual interest rate of 6%.

Capitalisation of borrowing costs should commence when the entity meets all three of the following conditions:

(1) It incurs expenditure on the asset (the payment to acquire the land was made on 1 October 2013);
(2) It incurs borrowing costs (the loan was taken out on 1 October 2013, from which date interest will start to accrue);
(3) It undertakes activities that are necessary to prepare the asset for its intended use (the land was acquired on 1 October 2013 with planning permission which was needed for construction to take place).

Borrowing costs of £36,000 (600,000 x 6%) should therefore be capitalised from 1 October 2013.

Where the borrowed funds are not required immediately, so instead are put on deposit, the borrowing costs capitalised should be reduced by the investment income received on the invested funds.

Investment income: (600,000 – 200,000 = 400,000)

(1 Oct 2013 – 28 Feb 2014)	400,000 x 3% x 5/12 =	£5,000
(1 Mar – 31 Aug 2014)	300,000 x 3% x 6/12 =	£4,500
(1 Sept – 30 Sept 2014)	100,000 x 3% x 1/12 =	£250
		£9,750

Total borrowing costs which should be capitalised are £26,250 (36,000 – 9,750). No depreciation should be recognised on the office block as it's not ready for use.

The journal entries required are:

	£	£
DR: Property, plant and equipment (SOFP)	26,250	
CR: Net interest (PorL)		26,250

(2) Convertible bonds

The convertible bonds are compound financial instruments per IAS 32 Financial Instruments: Presentation. They have both an equity and a liability component which should be presented separately at the time of issue. IAS 32 requires that the substance of such an instrument be reflected, focusing on the economic reality that in effect two financial instruments have been issued.

The liability component should be measured first at the present value of the capital and interest payments. The discount rate used should be the effective rate for an instrument with the same terms and conditions except without the ability to convert it into shares.

	Cash flow £	**Discount factor @ 7%**	**Present value** £
1 October 2014	30,000	1/1.07	28,037
1 October 2015	30,000	$1/1.07^2$	26,203
1 October 2016	30,000	$1/1.07^3$	24,489
1 October 2017 (redemption)	630,000	$1/1.07^4$	480,624
Liability component			559,353
Equity component (bal fig)			40,647
Total			600,000

The liability should initially be measured at £559,353 and the equity component is the residual at £40,647. Once recognised the equity element remains unchanged. However, the liability element should be shown at amortised cost at the end of each year:

1 Oct 2013	Interest (7%)	Payment (5%)	30 Sept 2014
£	£	£	£
559,353	39,155	(30,000)	568,508

At the year an adjustment should be made to non-current liabilities of £31,492 (600,000 – 568,508), and an additional £9,155 recognised as finance costs as part of profit or loss.

The journal entries required are:

	£	£
DR: Non-current liabilities (SOFP)	31,492	
DR: Finance costs (PorL)	9,155	
CR: Equity (SOFP)		40,647

(3) Intangible asset – licence

The licence should be recognised as an intangible asset as it is an identifiable non-monetary asset without physical substance. The licence is identifiable as it arises from contractual or legal rights to use the microchip technology.

The licence should initially be recognised at its cost of £72,000. Amortisation of £6,000 ((72,000 / 6yrs) x 6/12) should be recognised as part of profit or loss. The carrying amount of the licence at 30 September 2014 under historical cost accounting is £66,000 (72,000 – £6,000).

The licence can continue to be held at cost or may be revalued if the directors can show that an active market exists for it. Although a competitor has offered to buy the licence which suggests that an active market exists, part of the definition also requires the items traded to be homogenous. As it states that the licence is unique it is unlikely that it will meet this definition and therefore should be held at historical cost.

The revaluation gain of £18,000 (£90,000 - £72,000) at 30 September 2014 should be reversed.

The journal entries required are:

	£	£
DR: Equity – Revaluation surplus (SOFP)	18,000	
DR: Amortisation (PorL)	6,000	
CR: Non-current assets (SOFP) (18,000 + 6,000)		24,000

(4) Joint venture

Porcaro plc should recognise its investment in Barbarossa Ltd as a joint venture. Four companies have joint control over Barbarossa Ltd and there is a contractual arrangement in place to share profits and losses equally.

IFRS 11 Joint Arrangements requires the use of the equity method for joint ventures. The investment should therefore be recognised at cost of £25,000 plus the share of the joint venture's post acquisition increase in net assets, £32,500 (£130,000 x 25%).

The investment in Barbarossa Ltd will be shown as a non-current asset, rather than a current asset in the consolidated statement of financial position, so the £25,000 will need to be reclassified. The share of post-acquisition profit of £32,500 should be added to non-current assets, giving a carrying amount of £57,500 and the £32,500 recognised in consolidated profit or loss.

The journal entries required are:

	£	£
DR: Non-current assets (SOFP)	57,500	
CR: Current assets (SOFP)		25,000
CR: Share of joint venture profit (PorL)		32,500

Most candidates produced reasonably detailed narrative explanations, melded together with calculations although less went on to produce journal entries. Only the very weakest candidates restricted their answers to predominantly calculations, with little explanation. Answers to Issues (1), (2) and (4) were all reasonably well attempted, with Issue (3) causing some difficulties.

Borrowing costs
Most candidates set out the appropriate terminology, such as "directly attributable" and "qualifying asset", and correctly concluded that the office block was a qualifying asset and that interest on the loan should be capitalised. However, a significant number of candidates were careless in their choice of words and stated that borrowing costs "could" be capitalised – implying a choice in the matter (even when in Part (d) they went on to clearly state that under IFRS borrowing costs must be capitalised). Most then listed the IAS 23 criteria for the commencement of capitalisation, but few applied these criteria to this scenario. Of those that did, many concluded, in error, that capitalisation could not commence until 31 December 2013, and hence only capitalised nine months of the annual interest.

Almost all candidates stated that the borrowing costs should be reduced by the investment income on surplus funds. Calculations for the investment income often contained errors generally around the number of months. The 6% actual interest rate was used, although only a very small minority explained why this was appropriate. Almost all candidates then set out the correct journal entry for their net figure.

Convertible bonds
The majority of candidates explained that this was a compound financial instrument and that split accounting was appropriate, with fewer mentioning substance over form. Most of these candidates then produced correct calculations for the split of debt and equity and for the amortised cost of the debt, although less referred to "amortised cost" in their explanation. Journal entries were largely correct, although some candidates took a rather convoluted approach to arriving at the correct net journal.

Intangible asset – licence
This issue caused the most problems. Most candidates gave some basic definitions and calculated the initial carrying amount of the intangible at cost (although some used the incorrect number of months for the amortisation charge). Answers were then mixed, depending on whether candidates realised that the information in the scenario did not support the existence of an "active market". Those that saw this quickly concluded their answer by reversing out the revaluation. The ones that did not then wasted time calculating

additional amortisation charges, and sometimes also transfers between the revaluation surplus and retained earnings. Others hedged their bets and set out both accounting treatments without a conclusion, which was time consuming.

Joint venture

There was a lot of confusion to this issue and candidates seem to struggle between the concept of an associate and a joint venture, with many candidates simply believing they are the same instrument. Although the majority of candidates identified that equity accounting should be applied and recognised the cost correctly, candidates often described the investment as an associate. Journal entries were usually correct, with the most common error being to credit cash instead of current assets. The only real error seen in the calculations was taking the appropriate share of only a fraction of the profit after tax, instead of the appropriate share of the whole figure, which was stated to be the profit for that period.

Total possible marks	36
Maximum full marks	27

(b)

Porcaro plc – Group figures

	Profit for the year £	£
As stated		483,150
Issue (1)	26,250	
Issue (2)	(9,155)	
Issue (3)	(6,000)	
Issue (4)	32,500	
Profit adjustment		43,595
		526,745

Most candidates appeared to adopt the recommended approach of setting up a schedule as the first page of their answer starting with the draft profit from the question, and adjusted this as they wrote their explanation for each issue. Many candidates did therefore score the full two marks for this part, based sometimes on completely correct and sometimes on their "own" figures. Only the very weakest candidates failed to attempt this part of the question. Where marks were lost it was generally where candidates failed to replicate in this part the journal entries set out in their answers to Part (a).

Total possible marks	2
Maximum full marks	2

(c)

Porcaro plc

	No. Of shares	Period in issue	Bonus factor	Weighted average
1 Oct 2013 – 31 Jan 2014	270,000	4/12	210/200	94,500
Rights issue 1 for 3	90,000			
1 Feb – 30 Sept 2014	360,000	8/12		240,000
				334,500

Theoretical ex-rights price:	£
3 shares @ £2.10	6.30
1 share @ £1.70	1.70
	8.00

Theoretical ex-rights price per share £8.00 / 4 = £2.00
Bonus fraction: 210 / 200

Basic EPS = $\frac{526,745}{334,500}$ = £1.57

A rights issue is an issue of shares to current shareholders in proportion to their existing holdings at a discount to market price. Because the share issue is below market price, a rights issue is in effect a combination of an issue at full market value and a bonus issue. An adjustment therefore needs to be made to the earnings per share for the bonus element. This is calculated by comparing the pre-rights market value with the theoretical ex-rights price. The theoretical price is the price at which the shares would have traded after the rights issue in theory.

A good number of candidates arrived at the correct weighted average number of shares, and produced an EPS based on that and their own figure for revised profit for the year. However calculations often contained errors in the theoretical ex-rights price per share. Only the very best candidates could explain clearly why the rights issue had been scaled up by a bonus fraction, and many of these candidates achieved full marks for this part of the question. Weaker candidates merely described in words what they had done in their calculation. A minority of candidates described the accounting entries for the rights issue which gained no marks.

Total possible marks	7½
Maximum full marks	6

(d) UK GAAP differences

Borrowing costs

Under UK GAAP Porcaro plc has the choice whether to capitalise borrowing costs. If a policy of capitalisation is chosen then this policy should be applied to the class of qualifying assets.

Under IFRS borrowing costs which meet the definition of being directly attributable to the acquisition, construction or production of a qualifying asset must be capitalised.

Most candidates achieved the full one mark for this part, clearly stating that capitalisation is mandatory under IFRS, but optional under UK GAAP. Only the weakest candidates got this the wrong way round, or failed to give both the IFRS and UK GAAP treatments.

Total possible marks	1½
Maximum full marks	1

Question 3

Total marks: 11

Overall marks for this question can be analysed as follows**:**

General comments

This question was a mixed topic question, covering the completion of extracts from the statement of cash flows for adjustments to investing and financing activities. Part b) required the preparation of an extract from the consolidated statement of financial position, showing non-current and current assets.

Henrit plc

(a)

Consolidated statement of cash flows (extract)

Cash flows from investing activities	**£**
Purchase of property, plant and equipment (W2)	(365,450)
Proceeds from sale of property, plant and equipment (124,000 + 9,500)	133,500
Cash flows from financing activities	
Payment of finance lease (15,000 – 7,375) (W3)	(7,625)
Proceeds from issue of loan (450,000 – 290,000)	160,000

Workings

(1) Interest

	£
290,000 x 5% x 6/12	7,250
450,000 x 5% x 6/12	11,250
	18,500

(2) PPE

	£		**£**
B/d	729,400	Disposals	124,000
Additions – finance lease (W3)	105,350	Depreciation	113,000
Additions – cash (β)	365,450	C/d	963,200
	1,200,200		1,200,200

(3) Finance lease

	£		**£**
Cash	15,000	B/d	–
		PPE addition (β)	105,350
C/d	97,725	Interest (25,875 – 18,500 (W1))	7,375
	112,725		112,725

Answers to this requirement were quite mixed, with a significant number of candidates achieving full marks. Most candidates successfully calculated the proceeds from the disposal of equipment and also attempted to produce a T-account for property, plant and equipment to identify the cost of additions. Within this working nearly all candidates correctly credited the depreciation charge for the year and the carrying amount of the equipment that had been sold. The majority of candidates also realised that they needed to debit the account with plant acquired under a finance lease but very few candidates calculated this figure correctly. Most simply used the closing balance on the finance lease account given in the question.

It was clear that the majority of candidates either do not understand that payments under finance leases need to be split between interest and capital or cannot calculate the split. Many candidates merged the finance lease liability and the bank loan and as a result lost the easy mark available for showing the inflow of cash relating to the bank loan. Some candidates used the information given in the question to calculate the interest relating to the bank loan but then made no use of this information.

With regards to presentation nearly all candidates did produce extracts as required and also entered figures under the appropriate headings, although totals were often not seen. As is always the case with questions on the statement of cash flows a significant number of candidates lost marks for failing to put brackets around outflows of cash.

Total possible marks	8½
Maximum full marks	6

(b)

Statement of financial position at 30 September 2014 (extract)

Non-current assets

Property, plant and equipment (963,200 + 469,400 + 623,150 – 4,400 (W2))	2,051,350
Goodwill (73,400 + 17,750 (W1))	91,150

Current assets

Inventory (46,980 + 18,900 + 31,300 – 1,500 (W3))	95,680

Workings

(1) Goodwill – Crago Ltd

	£
Consideration transferred (230,000 + (45,000 x 3.15))	371,750
Non-controlling interest at acquisition at fair value	261,000
Less: Net assets at acquisition	(615,000)
	17,750

(2) Inter-company machine transfer

	£
Original carrying amount (95,000 – (95,000 x 3/5))	38,000
Consideration less depreciation (53,000 – (53,000 x 6/30))	(42,400)
Unrealised profit	4,400

(3) PURP

	%	£
SP	115	11,500
Cost	(100)	(10,000)
GP	15	1,500

Generally this was well answered with many candidates achieving full marks. A majority of candidates correctly calculated goodwill and the PURP relating to inventory and made the relevant adjustments to the figures given in the question. A minority of candidates used the nominal rather than the market value of the shares to calculate the consideration for the acquisition of the subsidiary and a similar number calculated the PURP using gross margin rather than a mark-up on cost.

However only a small minority of candidates correctly calculated the PURP relating to the sale of the machine. Common errors were to calculate the profit on disposal or the difference in the subsequent depreciation and therefore only adjust for part of the difference.

As with part (a) nearly all candidates produced extracts but again a number failed to add numbers across so could not be given full credit for presentation.

Total possible marks	6
Maximum full marks	5

Question 4

Total marks: 23

Overall marks for this question can be analysed as follows**:**

This question required the preparation of a consolidated statement of profit or loss and extracts from the consolidated statement of changes in equity (for retained earnings). The group had two subsidiaries, one of which was disposed of during the year. A fair value adjustment was required on acquisition of one of the companies. Inter-company trading took place during the year between one of the subsidiary's and the parent.

Part (b) required candidates to describe the UK GAAP differences for the acquisition and disposal of a subsidiary.

Mantia plc

(i) Consolidated statement of profit or loss for the year ended 30 September 2014

	£
Continuing operations	
Revenue (W1)	3,722,000
Cost of sales (W1)	(1,658,500)
Gross profit	2,063,500
Operating expenses (W1)	(536,055)
Profit from operations (W1)	1,527,445
Investment income (W1)	17,000
Profit before tax	1,544,445
Income tax expense (W1)	(327,000)
Profit for the year from continuing operations	1,217,445
Discontinued operations	
Profit for the year from discontinued operations (300,100 (W2) – 32,715 (W4))	267,385
Profit for the period	1,484,830
Profit attributable to	
Owners of Mantia plc (β)	1,327,451
Non-controlling interest (W2)	157,379
	1,484,830

(ii) Consolidated statement of changes in equity for the year ended 30 September 2014 (extract)

	Retained earnings £
Balance at 1 October 2013 (W6)	227,249
Total comprehensive income for the year	1,327,451
Dividends (W6)	(600,000)
Balance at 30 September 2014 (β)	954,700

Workings

(1) Consolidation schedule

	Mantia plc £	Appice Ltd £	Adj £	Consol £
Revenue	2,986,000	768,000	(32,000)	3,722,000
Cost of sales – per Q	(1,343,700)	(345,600)	32,000	(1,658,500)
– PURP (W5)		(1,200)		
Op expenses – per Q	(419,575)	(84,480)		(536,055)
– FV deprec (70,000/10yrs)		(7,000)		
– Impairment of goodwill	(25,000)			
Investment income	42,600			
– Appice (80,000 x 40p x 80%)			(25,600)	17,000
Tax	(259,000)	(68,000)		(327,000)
		261,720		

(2) Non-controlling interest in year

	£
Appice Ltd (20% x 261,720 (W1))	52,344
Starkey Ltd (35% x 300,100 (600,200 x 6/12))	105,035
	157,379

(3) Goodwill – Starkey Ltd

		£
Consideration transferred		230,000
Non-controlling interest at acquisition (302,000 x 35%)		105,700
		335,700
Less: Net assets at acquisition		
Share capital (91,000 / 65%)	140,000	
Retained earnings	162,000	
		(302,000)
Goodwill		33,700
Impairment brought forward		(18,000)
Goodwill at date of disposal		15,700

(4) Group profit/loss on disposal of Starkey Ltd

		£
Sale proceeds		427,000
Less: carrying amount of goodwill at disposal (W3)		(15,700)
Carrying amount of net assets at disposal		
Share capital	140,000	
Retained earnings (243,000 + (600,200 x 6/12))	543,100	
		(683,100)
Add back: Attributable to non-controlling interest (683,100 x 35%)		239,085
Loss on disposal		(32,715)

(5) PURP

	%	£
SP	100	32,000
Cost	(85)	(27,200)
GP	15	4,800
X $^{1}/_{4}$		1,200

(6) Retained earnings brought forward

	£	£
Mantia plc (596,300 – 1,006,325)		(410,025)
Add back dividend (500,000 x £1.20)		600,000
Appice Ltd – post acquisition change in net assets		
C/fwd retained earnings	384,200	
Less: retained earnings at acquisition	(136,000)	
Less: profit for the period	(269,920)	
Add back dividend (80,000 x 40p)	32,000	
Less: FV adjustment (70,000 / 10yrs)	(7,000)	
	3,280	
Appice Ltd – 3,280 x 80%		2,624
Starkey Ltd – post acquisition ((243,000 – 162,000) x 65%)		52,650
Less: impairment – Starkey Ltd		(18,000)
		227,249

Retained earnings carried forward (for proof only)

	£
Mantia plc	596,300
Appice Ltd – post acquisition (384,200 – 136,000 – 14,000 – 1,200) x 80%	186,400
Less: impairment – Appice Ltd	(25,000)
Profit on disposal of investment in Starkey Ltd (427,000 – 230,000)	197,000
	954,700

Most candidates made a good attempt at preparing the consolidation schedule and correctly excluded the subsidiary held for sale. Many dealt with the relevant adjustments correctly obtaining all the available marks for this part of the question. Where candidates did make errors it was normally for the following:

- deducting the inventory PURP from revenue rather than adding it to cost of sales or adding it to the cost of sales of the purchasing rather than the selling company.
- calculating the cumulative adjustment to depreciation arising from the fair value adjustment rather than just the current year adjustment and/or entering this into the parent company rather than the subsidiary's column.
- adjusting the subsidiary's profits for the goodwill impairment.
- deducting 100% of the subsidiary's dividend from investment income rather than just the parent company's share of the dividend.

Virtually all candidates attempted to calculate the profit on disposal and a reasonable number arrived at the correct figure. One common error was using the incorrect share capital figure (the shares bought by the parent company rather than total share capital) or ignoring share capital altogether when calculating net assets. Other errors included:

- failing to deduct the impairment from goodwill (many candidates deducted this from the profit on disposal instead).
- failing to add 6/12 of current year profit to brought forward retained earnings or deducting it rather than adding it.
- using retained earnings at acquisition rather than at the date of disposal when calculating net assets at disposal.

A number of candidates produced very disorganised workings for their retained earnings calculation and it was often difficult to understand where numbers had come from and whether they were increasing or decreasing the profit on disposal. Candidates are strongly advised to use the standard pro-forma given in the Learning Material to calculate this figure and label workings appropriately.

Most candidates did prepare a consolidated statement of profit or loss and showed a separate figure for the profit from discontinued operations. However this figure often ignored the profit up to disposal or just took the parent company's share of that profit. Candidates should note that if they only produce the consolidation schedule they will not get the presentation marks available for this statement.

As expected the extract to the consolidated statement of changes in equity was not as well dealt with. Most candidates who attempted this statement did insert the "easy" figures ie the profit for the period and the dividends paid. However errors were frequently made even with these figures by taking total profit for the period rather than just the profit attributable to the owners of the parent company and/or also including the

subsidiary's dividend as a deduction from retained earnings. Some candidates also showed dividends as an addition rather than a deduction to retained earnings. Relatively few candidates attempted to calculate retained earnings b/fwd or c/fwd. Where they did, workings were again often confused and difficult to follow. Few candidates appear to understand that they should take the same approach to calculate consolidated retained earnings as they do to calculate the consolidated retained earnings figure for consolidated statement of financial position questions.	
Total possible marks Maximum full marks	21½ 20

(b) UK GAAP differences	
Acquisition of Starkey Ltd The calculation for goodwill is the same under UK GAAP as per IFRS, however under IFRS the parent entity has a choice whether to measure the non-controlling interest at fair value or at the proportion of net assets. Under UK GAAP only the proportion of net assets method is permitted. UK GAAP requires goodwill to be amortised over its useful life and there is a rebuttable presumption that this should not exceed five years. Under IFRS amortisation is not permitted and instead annual impairment reviews take place. *Disposal of Starkey Ltd* UK GAAP requires that a detailed analysis of discontinued operations should be shown on the face of the profit and loss account. However, IFRS only requires a single line to be shown on the face of the statement of profit or loss.	
The majority of candidates made a good attempt at this part of the question with many achieving full marks. However a significant number of candidates wasted time by including differences that were not relevant to the scenario such as the treatment of a discount on acquisition. A common misunderstanding is that under UK GAAP goodwill must be amortised over five years rather than it being a maximum useful life.	
Total possible marks Maximum full marks	3½ 3

The Institute of Chartered Accountants in England and Wales

FINANCIAL ACCOUNTING AND REPORTING

For exams in 2014

Study Guide

www.icaew.com

Contents

1 Introduction

ACA Overview

The ICAEW chartered accountancy qualification, the ACA, is one of the most advanced learning and professional development programmes available. Its integrated components provide you with an in-depth understanding across accountancy, finance and business. Combined, they help build the technical knowledge, professional skills and practical experience needed to become an ICAEW Chartered Accountant.

Each component is designed to complement each other, which means that students can put theory into practice and can understand and apply what they learn to their day-to-day work. The components are:

Professional development

ICAEW Chartered Accountants are known for their professionalism and expertise. Professional development will prepare you to successfully handle a variety of different situations that you'll encounter throughout your career.

The ACA qualification improves your ability and performance in seven key areas:

- adding value
- communication
- consideration
- decision making
- problem solving
- team working
- technical competence.

Ethics and professional scepticism

Ethics is more than just knowing the rules around confidentiality, integrity, objectivity and independence.

It's about identifying ethical dilemmas, understanding the implications and behaving appropriately. We integrate ethics throughout the ACA qualification to develop students' ethical capabilities – so they will always know how to make the right decisions and justify them.

3-5 years practical work experience

Practical work experience is done as part of a training agreement with one of our 2,850 authorised training employers around the world. Students need to complete 450 days, which normally takes between three and five years. The knowledge, skills and experience they gain as part of their training agreement are invaluable, giving them the opportunity to put what they're learning into practice.

15 accountancy, finance and business modules

Each of the ACA modules is directly relevant to the work that students do on a day-to-day basis. They will gain in-depth knowledge across a broad range of topics in accountancy, finance and business.

There are 15 modules over three levels. These can be taken in any order with the exception of the Case Study which has to be attempted last. Students must pass every exam (or receive credit) – there are no options. This ensures that once qualified, all ICAEW Chartered Accountants have a consistent level of knowledge, skills and experience.

Certificate Level

There are six modules that will introduce the fundamentals of accountancy, finance and business.

They each have a 1.5 hour computer-based assessment which can be sat at any time. Students may be eligible for credit for some modules if they have studied accounting, finance, law or business at degree level or through another professional qualification.

These six modules are also available as a stand-alone certificate, the ICAEW Certificate in Finance, Accounting and Business (ICAEW CFAB). Students studying for this certificate will only complete the first six modules. On successful completion, the ICAEW CFAB can be used as a stepping stone to studying for the ACA.

The aim of the Accounting module is to develop a sound understanding of the techniques of double entry accounting and can apply its principles in recording transactions, adjusting financial records and preparing non-complex financial statements.

Professional Level

The next six modules build on the fundamentals and test students' understanding and ability to use technical knowledge in real-life scenarios. Each module has a 2.5–3 hour exam, which are available to sit four times per year. These modules are flexible and can be taken in any order. The Business Planning: Taxation and Business Strategy modules in particular will help students to progress to the Advanced Level.

The knowledge base that is put into place at Accounting is developed further in the Professional Level module of Financial Accounting and Reporting. The aim of this module is to enable students to prepare complete single entity and consolidated financial statements, and extracts from those financial statements, covering a wide range of International Financial Reporting Standards (IFRSs). Students will also be required to explain accounting and reporting concepts and ethical issues, and the application of IFRSs to specified single entity or group scenarios.

Advanced Level

The Corporate Reporting and Strategic Business Management modules test students' understanding and strategic decision making at a senior level. They present real-life scenarios, with increased complexity and implications from the Professional Level modules.

The Case Study tests all the knowledge, skills and experience gained so far. It presents a complex business issue which challenges students' ability to problem solve, identify the ethical implications and provide an effective solution.

The Advanced Level exams are fully open book, so they replicate a real-life scenario where all the resources are readily accessible.

2 Financial Accounting and Reporting

2.1 Module aim

To enable candidates to prepare complete single entity and consolidated financial statements, and extracts from those financial statements, covering a wide range of International Financial Reporting Standards (IFRS).

Candidates will also be required to explain accounting and reporting concepts and ethical issues, and the application of IFRS to specified single entity or group scenarios.

On completion of this module, students will be able to:

- Explain the contribution and inherent limitations of financial statements, apply the International Accounting Standards Board's (IASB) conceptual framework for financial reporting and identify and explain key ethical issues.
- Prepare and present financial statements from accounting data for single entities, whether organised in corporate or in other forms, in conformity with IFRS and explain the application of IFRS to specified single entity scenarios.
- Identify the circumstances in which entities are required to present consolidated financial statements, prepare and present them in conformity with IFRS and explain the application of IFRS to specified group scenarios.

Learning outcomes apply to non-specialised profit-oriented entities unless otherwise specified.

2.2 Specification grid

This grid shows the relative weightings of subjects within this module and should guide the relative study time spent on each. Over time the marks available in the assessment will equate to the weightings below, while slight variations may occur in individual assessments to enable suitably rigorous questions to be set.

	Weighting (%)
Accounting and reporting concepts and ethics	10
Single company financial statements	60
Consolidated financial statements	30
	100

The Financial Accounting and Reporting module will be 3 hours in length containing four or five written test questions. Candidates may use the IASB's IFRS open book text.

3 Study guide

3.1 Help yourself study for your ACA exams

The right approach

1 **Develop the right attitude**

Believe in yourself	Yes, there is a lot to learn. But thousands have succeeded before and you can too.
Remember why you're doing it	You are studying for a good reason: to advance your career.

2 **Focus on the exam**

Read through the Syllabus and Study Guide	These tell you what you are expected to know and are supplemented by **Examination context sections**.

3 **The right method**

See the whole picture	Keeping in mind how all the detail you need to know fits into the whole picture will help you understand it better. • The Introduction to each chapter in the study guide puts the material in context. • The **Learning objectives**, **Section overviews** and **Examination context sections** in the study manual show you what you need to **grasp**.
Use your own words	To absorb the information (and to practise your written communication skills), you need to **put it into your own words**. • **Take notes**. • Answer the **questions** in each chapter. • **Draw mindmaps**. • Try **'teaching' a subject** to a colleague or friend.
Give yourself cues to jog your memory	The Study Manual uses **bold** to **highlight key points**. • Try **colour coding** with a highlighter pen. • Write **key points** on cards.

4 **The right recap**

Review, review, review	Regularly reviewing a topic in summary form can **fix it in your memory**. The Study Manual helps you review in many ways. • Each **Chapter Summary** will help you to recall that study session. • The **Self-test** actively tests your grasp of the essentials. • Go through the **Examples** in each chapter a second or third time.

3.2 Study cycle

The best way to approach the Study Manual is to tackle the chapters in order. We will look in detail at how to approach each chapter below but as a general guide, taking into account your individual learning style, you could follow this sequence for each chapter.

Key study steps	Activity
Step 1 **Topic list**	This topic list is shown in the contents for each chapter and helps you navigate each part of the book; each numbered topic is a numbered section in the chapter.
Step 2 **Introduction**	The practical significance and working context sections for each chapter, set out in this study guide give you the big picture in terms of the context of the chapter. The content is referenced by the Study guide, and Examination context guidance shows what the examiners are looking for. The Introduction tells you why the topics covered in the chapter need to be studied.
Step 3 **Section overviews**	Section overviews give you a quick summary of the content of each of the main chapter sections. They can also be used at the end of each chapter to help you review each chapter quickly.
Step 4 **Explanations**	Proceed methodically through each chapter, particularly focusing on areas highlighted as significant in the chapter introduction or study guide.
Step 5 **Note taking**	Take brief notes, if you wish. Don't copy out too much. Remember that being able to record something yourself is a sign of being able to understand it. Your notes can be in whatever format you find most helpful; lists, diagrams, mindmaps.
Step 6 **Examples**	Work through the examples very carefully as they illustrate key knowledge and techniques.
Step 7 **Answers**	Check yours against the suggested solutions, and make sure you understand any discrepancies.
Step 8 **Chapter summary**	Review it carefully, to make sure you have grasped the significance of all the important points in the chapter.
Step 9 **Self-test**	Use the Self-test to check how much you have remembered of the topics covered.
Step 10 **Learning objectives**	Ensure you have ticked off the Learning objectives.

Moving on...

When you are ready to start revising, you should still refer back to the Study Manual.

- As a source of **reference** (you should find the index particularly helpful for this).
- As a way to **review** (the Section overviews, Examination context, Chapter summaries and Self-test questions help you here).

Remember to keep careful hold of the Study Manual – you will find it invaluable in your work.

3.3 Detailed study guide

Use this schedule and your exam timetable to plan the dates on which you will complete each study period below.

Revision phase – your revision should be centred around using the questions in the ICAEW Question Bank.

Study Period	Practical significance	Working context	Approach	Syllabus references and exam context	Due Date
1	**Reporting framework** In order to fully appreciate international accounting standards and their significance it is important to understand the regulatory background from which these accounting standards have come. Over time different practices and regulations have evolved to meet the requirements of national economic, financial and legal systems. The challenge of international harmonisation is to eliminate or reduce the differences, to produce a level playing field for financial reporting and to help create more efficient international capital markets. The globalisation of accounting standards and the convergence process is one of the events in the field of financial reporting in the last decade. This process is more than likely to continue with increasing effects on UK and other countries alike. **Stop and think** Have you ever wondered how a company's accountant/finance director decides which amounts should appear where in a set of annual financial statements? Part of the answer to this is the regulatory framework and the accounting standards that have come from that.	In all areas of accounting and reporting individuals will need a working knowledge of international accounting standards. A knowledge of the background to these standards is also important. As professional accountants you are expected to have a high level of personal and professional integrity and it is important that you are aware of the ethical standards that the ICAEW expects of you.	Read through this chapter of the Study Manual carefully as this is important background knowledge of which you must be aware. Take particular note of the section on ethics. This area will be covered in each topic as you progress through the Study Manual but this section gives you the detail you require. Finally work through the Self-test questions carefully to ensure that you have grasped the main points in the chapter.	In the examination, candidates may be required to: • Discuss the purpose of accounting regulations and standards for both profit-making and not-for-profit entities. • Explain, with examples, the objectives and limitations of financial statements. • Explain the qualitative characteristics of financial information and the constraints on such information. • Describe the financial effects of the application of the definitions in the IASB *Conceptual Framework*. • Perform simple calculations to demonstrate the difference between the accrual basis, cash accounting and the break-up basis. • Discuss and comment on the convergence process, including recent developments. • Identify and explain the ethical and professional issues for a professional accountant. **Specific syllabus references for this chapter are: 1a, 1b, 1c, 1d, 1e, 1f, 1g, 1i and 2g.**	

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2	**Format of financial statements** The way that financial information is presented to shareholders and other users is a fundamental part of financial accounting. Recent corporate scandals have increased public concern as to the adequacy of transparency in financial statements. Accounting standards provide guidance on presentation, although no system of rules can cover all eventualities. To ensure that financial statements are prepared to an adequate level it is important that entities are provided with a basic framework for the preparation of their financial statements. IAS 1 *Presentation of Financial Statements* provides a basic framework but still allows a degree of flexibility so that formats and headings can be adapted so that information is presented in a way that aids understanding. **Stop and think** Can you think of any advantages and disadvantages of standardised formats for financial statements?	You will have come across financial statements in the context of your working life. They are a fundamental part of accounting, audit and tax services. It is less likely these days that you will have had to prepare financial statements yourselves as this process is largely computerised. However, in order to understand financial information you need to know the basis on which the information has been prepared. Some of you may have come across not-for-profit organisations including charities, clubs and societies. This type of entity may have to comply with additional regulations, for example the Charities Act in the UK.	Chapter 2 is an important chapter as it introduces formats for the statement of financial position, statement of profit or loss and other comprehensive income, and statement of changes in equity. You must be able to reproduce these. You may also find it useful to refer to the Appendix at the end of the manual which includes a proforma set of financial statements. Section 10 deals with the financial statements of not-for-profit entities. Read through this section carefully. **Exam requirements** The ability to prepare financial statements for an individual entity (including the statement of cash flows) is a fundamental part of the Financial Accounting and Reporting syllabus and has a syllabus weighting of 60%. It will therefore be examined in some form at every sitting. A typical written test question would involve the preparation of, say, two of the main components of the financial statements from a trial balance, for example, a company statement of financial position and a statement of profit or loss. You would also be asked to make adjustments based on additional information and/or to produce notes to those financial statements. Alternatively, you could be asked to produce extracts from the financial statements.	In the examination, candidates may be required to: • Discuss the way IAS 1 builds on the principles contained in the IASB *Conceptual Framework*, including the following matters: – Fair/faithful presentation – Accrual basis – Going concern – Materiality • Draft in accordance with IAS 1: – A statement of financial position, distinguishing between current and non-current items – A statement of profit or loss and other comprehensive income – A statement of changes in equity – Notes to the financial statements – Candidates may be provided with trial balance/nominal ledger information or draft financial statements may be provided which need finalising. – Prepare the equity section of the statement of financial position of a not-for profit entity from financial and other data – Prepare a statement of cash flows in accordance with IAS 7 from an entity's statement of profit or loss and statement of financial position or finalise a draft statement of cash flows. **Specific syllabus references for this chapter are: 2a, 2b, 2c, 2e, 2g, 2h.**	

Study Period	Practical significance	Working context	Approach	Syllabus references and exam context	Due Date

3	**Reporting financial performance**
	
	One of the key financial statements is the statement of profit or loss and other comprehensive income which indicates the performance of the business for the accounting period.
	
	Many entities have operations in many different types of business and many different countries. This will almost always involve accounting for foreign currency transactions.
	
	Many entities will have individuals and other entities connected with them in some way or another. The basic assumption is that all transactions that entities make are 'arm's length' transactions but this may not always be the case for transactions with related parties. Therefore, disclosure of such related party transactions gives users the opportunity to reassess their view of the performance of the entity.
	
	Stop and think
	
	Information about discontinued operations is important in assessing the expected future performance of an entity, so it must be accurately presented in the financial statements.
		It is highly likely that entities that you come across in your work will operate in different business sectors and trade in several countries round the world. They may also have related party relationships with other individuals and entities.	Section 1 deals with IAS 8 and the effects of changes in accounting policy
			
			Section 2 deals with non-current assets held for sale and discontinued operations. Note the presentation of these items in the financial statements.
			
			Section 3 covers the treatment of foreign currency transactions and balances. This is at a very basic level and should not cause any problems.
			
			Read through section 4 carefully making particular note of the definitions involved in identifying related parties. This is a disclosure only standard, but you need to understand why it is important and be able to recognise related parties in a given scenario.
			
			Section 5 deals with the calculation of EPS. You must be able to calculate basic EPS including accounting for the effect of rights and bonus issues.
			
			Read through section 6 to give yourself an awareness of the rules on profits available for distribution. In the final section carefully note the differences between UK GAAP and international practice in each of the areas covered in the chapter.
			
			Finally, work through the Self-test questions carefully to ensure that you have grasped the main points in the chapter.
				In the examination, candidates may be required to:
				
				• Prepare financial statements or extracts including adjustments for:
				  – Changes in accounting policies
				  – Changes in accounting estimates
				  – Prior period adjustments
				  – Foreign currency transactions
				
				And be able to explain the required accounting treatment:
				
				• Identify and explain the circumstances in which an operation would meet the IFRS 5 definition of a discontinued operation.
				• Calculate basic EPS and comment on how it might be affected by different accounting policies.
				• Identify the distributable reserves for an entity and explain the rules surrounding the calculation.
				• Identify and discuss a related party situation.
				• Explain the difference between UK GAAP and international requirements, preparing simple calculations to illustrate.
				
				Specific syllabus references for this chapter are: 2a,2b,2c,2d,2e,2f.	

Study Period	Practical significance	Working context	Approach	Syllabus references and exam context	Due Date
4	**Property, plant and equipment** In most entities the carrying amount of property, plant and equipment is an extremely significant figure in their statement of financial position. Increasingly, for many entities, the value of their intangible assets is also a significant figure. As non-current assets are such a significant element of the statement of financial position, it is important that they are not overstated. Impairment reviews and asset writedowns should therefore regularly take place in accordance with IAS 36. **Stop and think** If an entity's statement of financial position shows a carrying amount for non-current assets of £1 million, a user of the financial statements would expect that those assets will provide a return of at least that amount to the business. If some of these assets are impaired, then this asset value could be misleading.	As a professional accountant you will frequently be required to deal with non-current assets. You must therefore know whether or not they are to be recognised in a statement of financial position, and at what amount. When you analyse a business, it is vital that you understand the basis on which the financial statements are prepared. The reporting policies have a direct effect on the view given by the financial statements.	Sections 1 – 3 deal with the basics of recognising and measuring property, plant and equipment. Section 4 looks at borrowing costs, which can also form part of the carrying amount of a non-current asset. Sections 5 – 7 deal with changes to the initial carrying amount of an asset, in particular depreciation and revaluation. pay particular attention to the impact of revaluation on the depreciation charge. Section 8 is important. Make sure that you learn the meaning of recoverable amount and the definition of the three figures that must be compared in order to determine recoverable amount. In the final section carefully note the differences between UK GAAP and international practice in each of the areas covered in this chapter. Finally, work through the Self-test questions carefully to ensure that you have grasped the main points in this chapter.	In the examination, candidates may be required to: • Explain how the IASB *Conceptual Framework* applies to the recognition of property, plant and equipment. • Prepare and present financial statements or extracts therefrom in accordance with: – IAS 16 *Property Plant and Equipment* – IAS 23 *Borrowing Costs* – IAS 36 *Impairment of Assets* – IFRS 5 *Non-current assets held for Sale and Discontinued operations* • Explain the accounting treatment of property, plant and equipment, borrowing costs, asset impairment and non-current assets held for sale. • Explain and illustrate the difference between the relevant treatment under IFRS and UK GAAP. • Identify and explain any ethical issues. **Specific syllabus references for this chapter are: 1b, , 2b, 2c, 2d 2e.**	

Study Period	Practical significance	Working context	Approach	Syllabus references and exam context	Due Date
5	**Intangible assets** In recent years the recognition and measurement of intangible assets has been one of the most controversial areas of financial reporting. As the nature of business has changed intangible assets have become a significant part of the value of an entity. The most important assets for many businesses are now brands, market positions, knowledge capital and people, but these are rarely recognised in financial statements. Bill Gates is said to estimate that 97% of the value of Microsoft is not recognised in the statement of financial position as a result. In contrast to the treatment of internally generated intangibles, acquired intangibles are normally recognised in the statement of financial position. For example, an entity that has acquired a brand, as opposed to internally generated an equally valuable brand, will recognise it, since a fair value can be attributed to it. As the acquirer has paid a price to acquire this brand, that price provides a reliable measure. Stop and think **Stop and think** Can you think of any other types of intangible assets that might add value to a business apart from those listed above?	At this stage of your training it is less likely that you will have had practical experience of the issues affecting intangible assets. You may have come across some of the more common examples including development expenditure, patents and goodwill. However, the issues affecting recognition and valuation of these assets are often complex and would normally be dealt with by more senior members of the audit team.	Read through Chapter 5 carefully. In section 2 note how the underlying principles of the IASB *Conceptual Framework* are reflected in IAS 38. Section 9 introduces the topic of goodwill which will be covered in more detail in Chapters 10 – 15. You should attempt all Interactive questions and Self-test questions to confirm your understanding of this topic. **Examination commentary** Intangible assets could be examined in the context of a question where extracts to the financial statements are required. Such a question could feature the treatment of research and development expenditure, goodwill or other intangibles. Alternatively, intangibles could feature in a published accounts question where financial statements are produced from a trial balance or could be examined within the context of group accounts. Questions could also focus on the way in which the accounting treatment of intangibles applies the principles of the IASB *Conceptual Framework.*	In the examination candidates may be required to: • Explain how the IASB *Conceptual Framework* applies to the recognition of intangible assets. • Prepare and present financial statements or extracts therefrom in accordance with: – IAS 38 *Intangible Assets* – IAS 36 *Impairment of Assets* • Explain the accounting treatment of intangible assets. • Explain and illustrate the difference between the relevant treatment under IFRS and UK GAAP. • Identify and explain any ethical issues. **Specific syllabus references for this chapter are: 1b, 2b, 2c, 2d, 2e.**	

Study Period	Practical significance	Working context	Approach	Syllabus references and exam context	Due Date
6	**Revenue and inventories** In more traditional businesses the point at which revenue should be recognised is usually straightforward. However, in recent years as business transactions have become more complex this area of accounting has become more controversial with some companies adopting aggressive, and in some cases questionable, accounting policies for revenue recognition. IAS 18 *Revenue* aims to provide guidance on when revenue can be recognised. The valuation of inventories will involve management judgement. For example, decisions will need to be made about which costs to allocate to individual items of inventory and estimates may need to be made regarding estimated selling prices in order to establish net realisable value. These decisions will have an impact not only on the carrying value of the asset but will also have a direct impact on reported profits. IAS 2 *Inventories* provides guidance in this area. **Stop and think** What is the relationship between revenue recognition and inventories?	Accounting for revenue and inventories is a complex area as there are many judgemental decisions which need to be made. As a result of this it is likely that more senior members of staff will be involved. If you work in audit you may have been involved in some aspects of this work, for example attending inventory counts.	Read through sections 1 and 2 of Chapter 6 and attempt Interactive question 1. Pay particular attention to section 2 which demonstrates how the concepts of IAS 18 *Revenue* apply to specific types of transactions. Then try Interactive questions 2 to 7. The remainder of this chapter then deals with inventories. You will have covered the basic principles involved in your Accounting studies so much of this will be revision. Notice however that the manual puts the topic into the context of IAS 2 *Inventories*. Complete Interactive question 8. You should also try all the Self-test questions to confirm your understanding of these topics. **Examination commentary** Revenue is most likely to feature in a mixed question or in a company accounts question where a statement of profit or loss is produced from a trial balance. Inventories could be examined in its own right although it is more likely to feature in a mixed question or a published accounts question.	In the examination, candidates may be required to: • Prepare and present financial statements or extracts therefrom in accordance with: – IAS 18 *Revenue* – IAS 2 *Inventories* • Explain the accounting treatment of revenue and inventories. • Explain the differences between the accounting treatment using the accrual basis and cash basis in relation to revenue recognition. • Know that the principles of revenue and inventory measurement and recognition are the same under IFRS and UK GAAP. **Specific syllabus references for this chapter are: 1b, 1f, 2b, 2c, 2d, 2e.**	

Study Period	Practical significance	Working context	Approach	Syllabus references and exam context	Due Date
7	**Leases** In Financial Accounting and Reporting the issue of how finance leases and operating leases should be accounted for by lessees is examined. Most assets are leased out by specialist lessors and financial institutions. In this paper we only look at leasing from the viewpoint of the lessee. An important source of finance for many entities comes in the form of the sale and leaseback of assets. An asset, typically a property, is sold to alleviate cash flow problems or release capital for investment opportunities, and then leased back. This allows continuing usage of the asset, albeit without legal ownership. These transactions can become quite complex and we consider the accounting treatment in a variety of circumstances. **Stop and think** Why do you think it is important to account for leasing transactions according to their substance rather than their legal form?	You are likely to come across more entities that are lessees than those that are lessors. Many entities enter into sale and leaseback transactions and therefore this is an area that you are likely to be exposed to.	Read carefully through section 3 and make sure you understand all the definitions as these are important when trying to determine the figures for accounting for a finance lease for a lessor. Work carefully through the example and interactive question. Sections 7 and 8 deal with operating leases. Make sure you know how to deal with rent-free periods. Read carefully through section 10 as sale and leaseback is an important area. Make sure that you understand that the accounting treatments depend upon whether the leaseback is a finance lease or an operating lease and on a comparison of the sales value to fair value and carrying amount. In the final section carefully note the differences between UK GAAP and International practice in each of the areas covered in this chapter. Finally work through the Self-test questions carefully to ensure that you have grasped the main points in this chapter.	In the examination, candidates may be required to: • Explain and apply the principle of substance over form. • Prepare and present financial statements or extracts therefrom in accordance with IAS 17 *Leases*. • Explain the accounting treatment of lessee accounting including sale and leaseback transactions and prepare relevant financial statement extracts. • Identify and explain the judgements to be made relating to the classification and treatment of leases and sale and leaseback transactions. • Explain and illustrate the differences between the relevant treatment under IFRS and UK GAAP. • Identify and explain any ethical issues. **Specific syllabus references for this chapter are: 2b, 2c, 2d, 2e.**	

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Study Period	Practical significance	Working context	Approach	Syllabus references and exam context	Due Date
8	**Financial instruments** In recent years there has been huge growth in the number and complexity of financial instrument. Historically many of these complex financial instruments were not even recorded in company statements of financial position as many derivatives, for example, had an immaterial initial cost. However, the implementation of IAS 32 and IAS 39 initially, followed by IFRS 7, has brought in detailed accounting and disclosure requirements for such financial instruments. **Stop and think** A company issues convertible loan stock which is almost certain to be converted into equity shares at some point in the future. Should this loan stock be classified as debt or as equity in the statement of financial position? What effect would the classification as debt or equity have on a user's interpretation of the financial statements?	As a professional accountant you will be working with the financial statements of many companies. Financial instruments, even the more complex ones, are so widespread and available for use by companies that they will inevitably feature in financial statements of companies of all different sizes. Even companies that you work with which have straightforward business and financial strategies enter into financial instrument transactions such as purchasing inventories using a foreign currency, raising asset-based finance and cash management activities.	The subject of financial instruments can be very complex. However, for Financial Accounting and Reporting purposes only the more straightforward areas are examinable. In section 1 the definitions of financial assets and liabilities are very important, so make careful note of these. In section 2 make sure that you understand what is meant by a compound instrument and work through the example showing how the equity and liability elements of such an instrument should be measured. Section 3 deals with how financial instruments should be measured, initially and subsequently. Note the workings for amortised cost. Section 4 deals with disclosures in respect of financial instruments, all of these now being contained in a single IFRS. Section 5 is very short, but read it carefully as the ethical considerations are important. Finally, work through the Self-test questions carefully to ensure that you have grasped the main points in the chapter.	In the examination, candidates may be required to: • Describe the recognition and derecognition criteria for financial instruments. • Calculate the liability and equity elements of compound financial instruments. • Classify financial instruments and prepare extracts of financial statements for basic financial instruments. • Calculate the carrying amount of a financial asset or liability measured at amortised cost using the effective interest method. • Recognise the correct accounting treatment of a variety of financial instruments. • Describe the disclosure requirements for financial instruments and their usefulness to users of financial instruments. • Identify ethical issues and professional judgements involving financial instruments and the effect this may have on financial performance and financial position. Points to note: Knowledge of derivatives is not required. Only those types of financial instruments included in the learning materials will be included in examination questions. Hedge accounting is excluded from the Professional Stage syllabus. **Specific syllabus references for this chapter are: 1d, 2a, 2b, 2c, 2d, 2e.**	

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9	**Other standards** This chapter deals with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets,* IAS 10 *Events after the Reporting Period,* and IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance.* Particularly important are requirements in respect of provisions. In the past provisions were sometimes used to manipulate profits, which is why IAS 37 provides specific guidance on when a provision should and should not be recognised. **Stop and think** A provision is set up in Year 1 (when profits are high) with the effect that profits are charged with an expense. In Year 2 when profits are lower the expenditure relating to that provision is incurred but is not recognised as an expense in profit or loss but charged to the provision in the statement of financial position instead. Effect? Profits in Year 1 are reduced – profits in Year 2 are increased – profits are smoothed.	Historically some entities have abused the use of provisions but this should no longer happen. However you will come across provisions, contingent liabilities, contingent assets and events after the reporting period in almost every entity's financial statements that you deal with.	Make sure that you understand the discounting of provisions and how that discount unwinds, covered in section 3. Do Interactive Question 2. Section 7 on IAS 10 is very straightforward. Section 8 deals with IAS 20. Make sure you can apply both methods of accounting for a government grant. Finally, work through the Self-test questions carefully to ensure that you have grasped the main points in the chapter.	In the examination, candidates may be required to: • Explain the IASB *Conceptual Framework* definitions and recognition principles and explain how they relate to IAS 37. • Prepare extracts from the financial statements and notes to the financial statements in respect of provisions and contingencies and explain the financial reporting treatment required. • Prepare financial statements or extracts taking into account the effect of events after the reporting period and explain the financial reporting treatment required. • Explain the accounting treatment of government grants. • Draft financial information including government grants. • Explain and illustrate the difference between the relevant treatment under IFRS and UK GAAP. • Identify and explain any ethical issues. **Specific syllabus references for this chapter are: 1d, 2b, 2c, 2d, 2e.**	

Study Period	Practical significance	Working context	Approach	Syllabus references and exam context	Due Date
10	**Group accounts: basic principles** In very simple terms a group is a collection of entities, where one, the parent, controls the activities of the others, its subsidiaries. In these circumstances the group is required to produce 'consolidated' financial statements. These present the position and results of the individual companies as if they were one entity. Examples of the issues involved include: • Whether an investment meets the definition of a subsidiary. • Whether there are circumstances when it might be appropriate to exclude a subsidiary from consolidation. • The value at which the net assets and results of the subsidiary should be consolidated. Relevant standards are: • IFRS 3 *Business Combinations* • IFRS 10 *Consolidated Financial Statements* • IFRS 12 *Disclosure of Interests in Other Entities* • IAS 27 *Separate Financial Statements* **Stop and think** From the shareholders' point of view what do you think the benefits are of consolidated financial statements?	If you work in a small or medium-sized firm you may have been involved in the preparation of consolidated financial statements. If you work in a large audit firm then a significant number of audit assignments are likely to involve the audit of a group of companies. This involves two key steps: • The financial statements of each individual entity within the group will be audited. • The consolidated financial statements will be audited by the principal auditor. The principal auditor is responsible for the overall audit opinion on the consolidated financial statements. You may have been involved in either of these steps.	The aim of this chapter is to set down the broad principles which are applied when preparing group financial statements. Work through it carefully reviewing the Worked examples and completing the Interactive questions. Because the preparation of consolidated financial statements makes up 30% of the syllabus, each paper will feature questions requiring either a consolidated statement of financial position or a consolidated statement of profit or loss. Some papers may also include questions requiring a consolidated statement of cash flows.	In the examination, candidates may be required to: • Explain and demonstrate the concepts and principles surrounding the consolidation of financial statements including: – The single entity concept – Substance over form – The distinction between control and ownership • Prepare the consolidated statement of financial position or statement of profit or loss (or extracts) including the results of the parent entity and one or more subsidiaries. **Specific syllabus references for this chapter are: 2b and 4b.**	

Study Period	Practical significance	Working context	Approach	Syllabus references and exam context	Due Date
11	**Group accounts: consolidated statement of financial position** The consolidated statement of financial position provides the owners of the group with important information over and above that which is available in the parent's own statement of financial position. The cost of the investment made in the subsidiary is replaced with the net assets controlled by the parent company. This application of substance over form provides a more realistic representation of what their investment is really worth as the statements of financial position of the parent and subsidiary are produced as if they were a single entity. The single entity concept has more detailed implications for the preparation of the statement of financial position which we will look at in this chapter. **Stop and think** Why is information about the assets and liabilities of the subsidiary of more use to the shareholders than the cost of their investment?	The preparation of the consolidated statement of financial position involves the combination of the individual statements of financial position of the group members. As we said in Chapter 10, this process is often computerised. However, detailed work will be needed on the consolidation adjustments. This might include for example, establishing fair values at the date of acquisition so that goodwill can be correctly calculated and the identification and elimination of intra-group balances. In this chapter, we will look at consolidation adjustments from the perspective of the consolidated statement of financial position. Chapter 12 considers the same consolidation adjustments from the perspective of the consolidated statement of profit or loss.	Chapter 11 applies the principles introduced in Chapter 10 to the consolidated statement of financial position specifically. Note the technique to answering questions on this topic. Sections 5 – 7 introduce a number of consolidation adjustments. These may feature in full consolidation questions or questions requiring extracts or discussion of principles, so review these carefully. Issues in this area, include goodwill calculations, fair value adjustments and the elimination of intra-group transactions and balances.	In the examination candidates may be required to: • Prepare a consolidated statement of financial position (or extracts therefrom) including the results of the parent entity and one or more subsidiaries from individual financial statements or draft consolidated financial statements and including adjustments for the following: – Acquisition of a subsidiary, including mid-year acquisitions – Goodwill – Intra-group items – Unrealised profits – Fair values • Other consolidation adjustments. • Explain the process of preparing a consolidated statement of financial position in the context of the single entity concept, substance over form and the distinction between control and ownership. • Explain the two methods of measuring the non-controlling interest at acquisition and prepare financial information by the two methods. **Specific syllabus references for this chapter are: 1d, 1h, 3d, 3e, 3f, 3g.**	

Study Period	Practical significance	Working context	Approach	Syllabus references and exam context	Due Date
12	**Consolidated statements of financial performance** The consolidated statement of profit or loss provides the owners of the group with important information over and above that which is available in the parent's own income statement. The investment income receivable from the subsidiary is replaced with the profits controlled by the parent company. The consolidated statement of changes in equity provides a 'bridge' between the consolidated statement of financial position and consolidated statement of profit or loss or statement of profit or loss and other comprehensive income. It achieves this by reconciling the group's opening equity (capital, reserves and non-controlling interest) to the closing position. Note Consolidation issues arise in profit or loss rather than in other comprehensive income, so in this chapter we concentrate on the **statement of profit or loss**. **Stop and think** Why is information about the profits of the subsidiary of more use to the shareholders than information about the investment income received?	In very simple terms, the preparation of the consolidated statement of profit or loss and consolidated statement of changes in equity involves the combination of the individual statements of the group members. As we said in Chapter 10, this process is often computerised. However, detailed work will be needed on the consolidation adjustments, particularly in respect of the consolidated statement of profit or loss. This might include the identification and elimination of intra-group transactions and the elimination of unrealised profit. We will look at a number of consolidation adjustments in this chapter.	Section 2 deals with the major issues in preparing the consolidated income statement – intra-group trading and non-current assets transfers. Do Interactive questions 1 and 2. Section 3 shows you the standard workings which you should learn for the exam. Interactive question 3 will take you through these. Make sure you understand how to deal with a mid-year acquisition and go carefully through Section 7 on the Consolidated statement of changes in equity.	In the examination candidates may be required to: • Prepare a consolidated statement of profit or loss (or extracts therefrom) including the results of the parent entity and one or more subsidiaries from individual financial statements or draft consolidated financial statements and including adjustments for the following: – Acquisition of a subsidiary, including a mid-year acquisition – Intra-group transactions – Unrealised profits – Interest and management charges • Explain the preparation of a consolidated statement of profit or loss in the context of the single entity concept, substance over form and the distinction between control and ownership. • Prepare a consolidated statement of changes in equity (or extracts there from) including the effects of new and continuing interests in subsidiaries. **Specific syllabus references for this chapter are: 1d, 1h, 3d, 3e, 3f, 3g.**	

Study Period	Practical significance	Working context	Approach	Syllabus references and exam context	Due Date
13	**Associates and joint ventures** In Chapters 10 – 12 we have seen that companies may acquire other entities as a means of achieving growth and meeting corporate objectives. We have been looking at situations where an investor obtains *control* of an investee through the ownership of a majority of the ordinary share capital. However, there are other ways in which an investment may be made. A non-controlling stake could be obtained such that the investor can *influence, rather than control*, the key decisions made by the entity. This is normally achieved through the acquisition of 20% or more of the voting rights (normally attached to ordinary shares). This type of investment is referred to as an associate. Another option is the acquisition of joint control by entering into a joint venture with other parties. Joint ventures are accounted for using the equity method – the same method used for associates. **Stop and think?** How do you think a simple trade investment differs from an investment in an associate or in a joint venture?	If you have worked on a client which involves a group of companies the investments made by the parent company may have included an associate or a joint venture. As we saw in Chapter 10 the subsidiaries in a group are normally consolidated by preparing a consolidation package. Typically the same type of procedure is used in respect of an associate or joint venture. The key issues which would need to be addressed specifically include the correct identification of the investment as an associate or joint venture and the appropriate accounting treatment in the financial statements.	Chapter 13 deals with the treatment of an associate or joint venture in the consolidated financial statements. Read through section 1, paying particular attention to the definition of significant influence. Then move on to the equity method in sections 2 and 3. Review these sections carefully working through Interactive question 1 and 2. Make sure that you understand the difference between this method and the consolidation technique used for subsidiaries. Work through section 5. Make sure that you appreciate that the treatment of unrealised profits will depend on whether the associate or the parent is the selling company. Sections 6 – 8 cover joint ventures. These are also accounted for using the equity method. Section 9 deals with disclosure requirements under IFRS 12.	In the examination candidates may be required to: • Incorporate the results of an associate in the consolidated financial statements using the equity method. • Explain the equity method and the principles behind it. • Incorporate the results of a joint venture in the consolidated financial statements. **Specific syllabus references for this chapter are: 3c,3d, 3e, 3f, 3g.**	

Study Period	Practical significance	Working context	Approach	Syllabus references and exam context	Due Date
14	**Group accounts: disposals** So far, we have been looking at the circumstances in which one entity acquires an investment in another entity. However, the decision to dispose of an investment is an equally important decision. A company may decide to dispose of an investment for a number of reasons, including: • The need to generate cash. • The fact that the investment does not fit in with future strategic plans. • Underperformance of the investment. This chapter considers the accounting treatment of the disposal of a subsidiary. **Stop and think** What kinds of strategic decisions might lead to the disposal of an investment?	Where a subsidiary has been disposed of there are a number of key issues which the accountant will need to consider. The most important of these considerations will include establishing the date of disposal and the net assets of the subsidiary at the disposal date. The disposal must be appropriately accounted for and disclosed.	Chapter 14 covers a lot of technical detail, dealing with the disposal of subsidiaries. You may find the summary table at the end of the chapter useful as it provides an overview of the topic. Sections 2 – 3 cover the disposal of a subsidiary. Try to ensure that you can calculate the group profit or loss on disposal and that you understand the implications for the consolidated financial statements. Also notice that the complete disposal of a subsidiary constitutes a discontinued activity which should be disclosed as such. Preparation of consolidated financial statements represents 30% of the syllabus and disposals of subsidiaries forms part of this. Questions are likely to focus on the impact of the disposal on the consolidated financial statements as a whole.	In the examination candidates may be required to: • Prepare consolidated financial statements including the effects of a complete disposal of a subsidiary. • Prepare extracts from the consolidated financial statements including the calculation of the group profit or loss on complete disposal of a subsidiary. • Explain the principles behind the treatment of the complete disposal of a subsidiary. **Specific syllabus references for this chapter are: 1g, 3d, 3e, 3f.**	

Study Period	Practical significance	Working context	Approach	Syllabus references and exam context	Due Date
15	**Group statement of cash flows** The process involved in preparing a consolidated statement of cash flows is very similar to that used in the preparation of a statement of cash flows for an individual entity. **Stop and think** What information do investors obtain from a group statement of cash flows?	If you have worked for a large company you may have worked on a group statement of cash flows.	Section 1 is a useful recap of the method of preparing the statement of cash flows. Note the treatment of finance leases. Section 2 goes over the particular issues involved in a group statement of cash flows – acquisitions and disposals, dividends paid to the non-controlling interest and dividends received from associates and joint ventures. In acquiring a subsidiary, the parent will probably also be acquiring cash balances and these will need to be adjusted for. Note also that the affect of assets and liabilities acquired on the group working capital movements will have to be accounted for. Interactive Question 4 is good practice for this. Make sure you do self-test questions 9 and 10.	In the examination candidates may be required to: • Prepare a consolidated statement of cash flows for a group of companies including subsidiaries and associates. • Prepare extracts from a consolidated statement of cash flows. **Specific syllabus references for this chapter are: 2c, 2d, 3e.**	

4 Syllabus and learning outcomes

1 Accounting and reporting concepts and ethics

Candidates will be able to explain the contribution and inherent limitations of financial statements apply the International Accounting Standards Board's conceptual framework for financial reporting and identify and explain key ethical issues.

In the assessment, candidates may be required to:

		Covered in chapter
(a)	Explain the standard-setting process used by UK and international bodies and the authority of UK and international standards, using appropriate examples as illustration.	1
(b)	Explain the objectives and inherent limitations of financial statements, giving appropriate examples.	1
(c)	Explain the qualitative characteristics of financial information and the constraints on such information, using appropriate examples to illustrate the explanation.	1
(d)	Identify the financial effects of transactions in accordance with the IASB Conceptual Framework.	1
(e)	Discuss the concepts of "fair presentation" and "true and fair view" and the circumstances in which these concepts may override the detailed provisions of legislation or of accounting standards.	1
(f)	Explain the differences between financial statements produced using the accrual basis and those produced using the bases of cash accounting and break-up, performing simple calculations to illustrate the differences.	1
(g)	Explain, in non-technical language, the different bases of measurement of the elements of the financial statements and the different definitions of capital and capital maintenance used in accrual basis financial statements, illustrating the explanation with simple calculations and examples.	1
(h)	Explain and demonstrate the concepts and principles surrounding the consolidation of financial statements.	10
(i)	Identify and explain the ethical and professional issues for a professional accountant undertaking work in financial accounting and reporting and identify appropriate action.	1,8

2 Single entity financial statements

Candidates will be able to prepare and present financial statements from accounting data for single entities, whether organised in corporate or in other forms, in conformity with IFRS requirements and explain the application of IFRS to specified single entity scenarios.

In the assessment, candidates may be required to:

(a)	Identify the laws and regulations, and accounting standards and other requirements applicable to the statutory financial statements of an entity.	1,2
(b)	Calculate from financial and other data the amounts to be included in an entity's financial statements according to the international financial reporting framework.	2,3,4,5,6,7,8,9
(c)	Prepare and present the financial statements, or extracts therefrom, of an entity according to its accounting policies and appropriate international financial reporting standards.	2,3,4,5,6,7,8,9
(d)	Explain the application of IFRS to specified single entity scenarios.	2,3,4,5,6,7,8,9
(e)	Explain the principal differences between IFRS and UK GAAP and prepare simple extracts from single entity financial statements in accordance with UK GAAP.	2,3,4,5,6,7,8,9
(f)	Define and calculate from information provided the distributable profits of an entity.	3
(g)	Identify the circumstances in which the use of IFRS, and International Public Sector Accounting Standards (IPSASs) for not-for-profit entities might be required.	1,2

Covered in chapter

(h) Calculate from financial and other data the amounts to be included in the equity section of the statement of financial position of a not-for-profit entity in accordance with its accounting policies and the appropriate financial reporting framework. 1,2

3 Consolidated financial statements

Candidates will be able to identify the circumstances in which entities are required to present consolidated financial statements, prepare and present them in conformity with IFRS and explain the application of IFRS to specified group scenarios.

In the assessment, candidates may be required to:

(a) Identify and describe the circumstances in which an entity is required to prepare and present consolidated financial statements. 10

(b) Identify the laws and regulations, and accounting standards and other requirements applicable to the legal entity and consolidated financial statements of an entity. 10

(c) Identify from financial and other data any subsidiary or associate of an entity according to the international financial reporting framework. 10

(d) Calculate from financial and other data the amounts to be included in an entity's consolidated financial statements in respect of its new, continuing and discontinuing interests in subsidiaries and associates according to the international financial reporting framework. 10,11,12,13,14,15

(e) Prepare and present the consolidated financial statements, or extracts therefrom, of an entity in accordance with its accounting policies and the international financial reporting framework, using calculated amounts and other information. 10, 11, 12, 13, 14, 15

(f) Explain the application of IFRS to specified group scenarios. 10, 11, 12, 13, 14, 15

(g) Explain the principal differences between IFRS and UK GAAP and prepare simple extracts from consolidated financial statements in accordance with UK GAAP. 11

5 Skills assessment guide

5.1 Technical knowledge

The tables contained in this section show the technical knowledge in the disciplines of financial reporting, audit and assurance, business analysis, ethics and taxation covered in the ACA syllabus by module.

For each individual standard the level of knowledge required in the relevant Certificate and Professional Level module and at the Advanced Level is shown.

The knowledge levels are defined as follows:

Level D

An awareness of the scope of the standard.

Level C

A general knowledge with a basic understanding of the subject matter and training in its application sufficient to identify significant issues and evaluate their potential implications or impact.

Level B

A working knowledge with a broad understanding of the subject matter and a level of experience in the application thereof sufficient to apply the subject matter in straightforward circumstances.

Level A

A thorough knowledge with a solid understanding of the subject matter and experience in the application thereof sufficient to exercise reasonable professional judgement in the application of the subject matter in those circumstances generally encountered by Chartered Accountants.

Key to other symbols:

→ the knowledge level reached is assumed to be continued

Financial Reporting

Title	Certificate & Professional Level		Advanced Level
	Accounting	Financial Accounting & Reporting	Accounting
Preface to International Financial Reporting Standards		A	A
Conceptual Framework for Financial Reporting	B	A	A
IAS 1 Presentation of Financial Statements	A	A	A
IAS 2 Inventories	B	A	A
IAS 7 Statement of Cash flows	B	A	A
IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors	B	A	A
IAS 10 Events after the Reporting Period		A	A
IAS 11 Construction Contracts			A
IAS 12 Income Taxes		C	A
IAS 16 Property, Plant and Equipment	B	A	A
IAS 17 Leases		B	A
IAS 18 Revenue	B	A	A
IAS 19 Employee Benefits			A
IAS 20 Accounting for Government Grants and Disclosure of Government Assistance		A	A
IAS 21 The Effects of Changes in Foreign Exchange Rates		C	A
IAS 23 Borrowing Costs		C	A
IAS 24 Related Party Disclosures		B	A
IAS 26 Accounting and Reporting by Retirement Benefit Plans		-	D
IAS 27 (IFRS 10) Consolidated and Separate Financial Statements		B	A
IAS 28 Investments in Associates		B	A
IAS 29 Financial Reporting in Hyperinflationary Economies			D
IAS 31 (IFRS 11) Interests in Joint Ventures		B	A
IAS 32 Financial Instruments: Presentation		B	A
IAS 33 Earnings Per Share		C	A
IAS 34 Interim Financial Reporting			A
IAS 36 Impairment of Assets		B	A
IAS 37 Provisions, Contingent Liabilities and Contingent Assets	C	A	A

Title	Certificate & Professional Level		Advanced Level
	Accounting	Financial Accounting & Reporting	Accounting
IAS 38 Intangible Assets	C	A	A
IAS 39 Financial Instruments: Recognition and Measurement		C	A
IAS 40 Investment Property		-	A
IAS 41 Agriculture		-	D
IFRS 1 First-Time Adoption of IFRS		-	A
IFRS 2 Share-based Payment		-	A
IFRS 3 Business Combinations		B	A
IFRS 4 Insurance Contracts		-	D
IFRS 5 Non-Current Assets Held for Sale and Discontinued Operations		B	A
IFRS 6 Exploration for and Evaluation of Mineral Resources		-	D
IFRS 7 Financial Instruments: Disclosures		B	A
IFRS 8 Operating Segments		-	A
IFRS 9 Financial Instruments		-	C
IFRS for SMEs		-	A
IFRS 10 Consolidated Financial Statements		B	A
IFRS 11 Joint Arrangements		B	A
IFRS 12 Disclosure of Interests in Other Entities		B	A
IFRS 13 Fair Value Measurement		C	A

6 Key resources

Student support team

Our student support team are here to help you as much as possible, providing full support throughout your studies.

T +44 (0)1908 248 250
F +44 (0)1908 248 069
E studentsupport@icaew.com

Student website

The student area of our website provides you with information on exam applications, deadlines, results and regulations as well as applying for credit for prior learning (CPL)/exemptions. The study resources section includes advice from the examiners, module syllabi, past papers and sample papers, webinars and study guides. The study guides are designed to help put the learning for each module into context and highlight the practical significance of what you'll learn. They also include the syllabus, technical knowledge grids and learning outcomes for each module, enabling you to gain an overview of how your learning links to the qualification. Visit icaew.com/students for these resources and more.

Online student community

The online student community is a forum to ask questions, gain study and exam advice from fellow ACA and CFAB students and access our free webinars. There are also regular Ask a Tutor sessions to help you with key technical topics and exam papers. Access the community at icaew.com/studentcommunity

Tuition

The ICAEW Partner in Learning scheme recognises tuition providers who comply with our core principles of quality course delivery. If you are receiving structured tuition with an ICAEW Partner in Learning, make sure you know how and when you can contact your tutors for extra help. If you are not receiving structured tuition and are interested in classroom, online or distance learning tuition, take a look at our recognised Partner in Learning tuition providers in your area, on our website icaew.com/students

Faculties and Special Interest Groups

Faculties and special interest groups support and develop members and students in areas of work and industry sectors that are of particular interest. There are seven faculties which provide knowledge, events and essential technical resources, including the Financial Reporting faculty. Our 12 groups provide practical support, information and representation within a range of industry sectors including Charity and Voluntary, Entertainment and Media, Farming and Rural Business, Forensic, Healthcare, Insolvency, Valuation, Tourism and Hospitality, and more. Students can register free of charge for provisional membership of one special interest group and receive a monthly complimentary e-newsletter from one faculty of their choice. To find out more and to access a range of free resources, visit icaew.com/students

The Library & Information service (LIS)

The Library & Information service (LIS) is ICAEW's world-leading accountancy and business library. You have access to a range of resources free of charge via the library website, including the catalogue, LibCat. Visit icaew.com/library for more details.

ICAEW

LATEST EVOLUTION OF THE ACA SYLLABUS 2014

PROFESSIONAL LEVEL – FINANCIAL ACCOUNTING AND REPORTING

ACA OVERVIEW

The ICAEW chartered accountancy qualification, the ACA, is one of the most advanced learning and professional development programmes available. Its integrated components provide an in-depth understanding across accountancy, finance and business. Combined, they help build the technical knowledge, professional skills and practical experience needed to become an ICAEW Chartered Accountant.

Each component is designed to complement each other, which means that students can put theory into practice and can understand and apply what they learn to their day-to-day work. The components are:

Professional development

ICAEW Chartered Accountants are known for their professionalism and expertise. Professional development prepares students to successfully handle a variety of different situations that they encounter throughout their career.

The ACA qualification improves students' ability and performance in seven key areas:

- adding value
- communication
- consideration
- decision making
- problem solving
- team working
- technical competence.

Ethics and professional scepticism

Ethics is more than just knowing the rules around confidentiality, integrity, objectivity and independence. It's about identifying ethical dilemmas, understanding the implications and behaving appropriately. We integrate ethics throughout the ACA qualification to develop students' ethical capabilities – so they will always know how to make the right decisions and justify them.

3-5 years practical work experience

Practical work experience is done as part of a training agreement with one of our 2,850 authorised training employers around the world. Students need to complete 450 days, which normally takes between three and five years. The knowledge, skills and experience they gain as part of their training agreement are invaluable, giving them the opportunity to put what they're learning into practice.

15 accountancy, finance and business modules

Each of the ACA modules is directly relevant to the work that students do on a day-to-day basis. They will gain in-depth knowledge across a broad range of topics in accountancy, finance and business.

There are 15 modules over three levels. These can be taken in any order with the exception of the Case Study which has to be attempted last. Students must pass every exam (or receive credit) – there are no options. This ensures that once qualified, all ICAEW Chartered Accountants have a consistent level of knowledge, skills and experience.

Certificate Level

There are six modules that will introduce the fundamentals of accountancy, finance and business. They each have a 1.5 hour computer-based assessment which can be sat at any time. Students may be eligible for credit for some modules if they have studied accounting, finance, law or business at degree level or through another professional qualification.

These six modules are also available as a stand-alone certificate, the ICAEW Certificate in Finance, Accounting and Business (ICAEW CFAB). Students studying for this certificate will only complete the first six modules. On successful completion, the ICAEW CFAB can be used as a stepping stone to studying for the ACA.

Professional Level

The next six modules build on the fundamentals and test students' understanding and ability to use technical knowledge in real-life scenarios. Each module has a 2.5–3 hour exam, which are available to sit four times per year. These modules are flexible and can be taken in any order. The Business Planning: Taxation and Business Strategy modules in particular help students to progress to the Advanced Level.

Advanced Level

The Corporate Reporting and Strategic Business Management modules test students' understanding and strategic decision making at a senior level. They present real-life scenarios, with increased complexity and implications from the Professional Level modules.

The Case Study tests all the knowledge, skills and experience gained so far. It presents a complex business issue which challenges students' ability to problem solve, identify the ethical implications and provide an effective solution.

The Advanced Level exams are fully open book, so they replicate a real-life scenario where all the resources are readily accessible.

CERTIFICATE AND PROFESSIONAL LEVELS

Aim

The Certificate and Professional Levels of the ACA qualification aim to provide students with the technical skills and underpinning knowledge to perform their work as trainee chartered accountants in a variety of environments.

The Certificate and Professional Level syllabuses have been constructed with the following aims:

- to ensure that the required technical knowledge and skills can be learnt and assessed in a comprehensive and rigorous manner;
- to allow the timing of exam study to be aligned with the knowledge and skills needed in the work place; and
- to enable appropriate educational progression and reinforcement during the study and assessment process.

Structure and progression

The six modules at the Certificate Level focus on the introduction and development of core knowledge and skills. The modules at the Professional Level further develop the knowledge and skills and assess practical technical competency.

The Certificate and Professional Levels form the foundation of technical knowledge that is further developed and integrated at the Advanced Level.

Assessment

The six Certificate Level modules are examined using computer-based assessments. Each computer-based assessment is 1.5 hours long.

The six Professional Level modules are examined using traditional paper-based exams. Each paper-based exam is 2.5 hours long with the exception of the Financial Accounting and Reporting exam which is 3 hours long.

Flexibility

There are no regulations stipulating the order in which students must attempt the Certificate and Professional Level modules, allowing employers to design training programmes according to business needs. Students will be permitted a maximum of four attempts at each module.

Credit for prior learning

Students with previous qualifications may be eligible to apply for credit for prior learning (CPL) / exemptions for up to 12 modules. For more information, visit icaew.com/cpl

Open book policy

For some Professional Level modules, students are permitted to take certain publications into the examination room. Details of these publications and our open book policy can be found within the student resources area of our website.

FINANCIAL ACCOUNTING AND REPORTING

Module aim

To enable candidates to prepare complete single entity and consolidated financial statements, and extracts from those financial statements, covering a wide range of International Financial Reporting Standards (IFRS).

Candidates will also be required to explain accounting and reporting concepts and ethical issues, and the application of IFRS to specified single entity or group scenarios.

On completion of this module, students will be able to:

- explain the contribution and inherent limitations of financial statements, apply the International Accounting Standards Board's (IASB) conceptual framework for financial reporting and identify and explain key ethical issues;
- prepare and present financial statements from accounting data for single entities, whether organised in corporate or in other forms, in conformity with IFRS and explain the application of IFRS to specified single entity scenarios; and
- identify the circumstances in which entities are required to present consolidated financial statements, prepare and present them in conformity with IFRS and explain the application of IFRS to specified group scenarios.

Learning outcomes apply to non-specialised profit-oriented entities unless otherwise specified.

Method of assessment

The Financial Accounting and Reporting module will be 3 hours long containing four or five written test questions. Candidates may use the IASB's IFRS open book text.

The module will include questions on:

a. preparation of single entity financial statements from trial balance or draft financial statements; and
b. preparation of consolidated financial statements from individual financial statements or draft consolidated financial statements.

Other question types could include, inter alia:

a. written questions explaining the application of IFRS to specified scenarios; and
b. mixed or single topic questions requiring extracts and/or calculations.

Concepts and ethics will be tested in any of the written test questions.

Specification grid

This grid shows the relative weightings of subjects within this module and should guide the relative study time spent on each. Over time the marks available in the assessment will equate to the weightings below, while slight variations may occur in individual assessments to enable suitably rigorous questions to be set.

Syllabus area	Weighting (%)
1 Accounting and reporting concepts and ethics	10
2 Single entity financial statements	60
3 Consolidated financial statements	30
	100

The following learning outcomes should be read in conjunction with the Financial Reporting table in the evolved ACA technical knowledge grid, which contains the list of examinable IFRSs.

1 Accounting and reporting concepts and ethics

Candidates will be able to explain the contribution and inherent limitations of financial statements, apply the International Accounting Standards Board's conceptual framework for financial reporting and identify and explain key ethical issues.

In the assessment, candidates may be required to:

a. explain the standard-setting process used by UK and international bodies and the authority of UK and international standards, using appropriate examples as illustration
b. explain the objectives and inherent limitations of financial statements, giving appropriate examples
c. explain the qualitative characteristics of financial information and the constraints on such information, using appropriate examples to illustrate the explanation
d. identify the financial effects of transactions in accordance with the IASB Conceptual Framework
e. discuss the concepts of "fair presentation" and "true and fair view" and the circumstances in which these concepts may override the detailed provisions of legislation or of accounting standards
f. explain the differences between financial statements produced using the accrual basis and those produced using the bases of cash accounting and break-up, performing simple calculations to illustrate the differences
g. explain, in non-technical language, the different bases of measurement of the elements of the financial statements and the different definitions of capital and capital maintenance used in accrual basis financial statements, illustrating the explanation with simple calculations and examples
h. explain and demonstrate the concepts and principles surrounding the consolidation of financial statements
i. identify and explain the ethical and professional issues for a professional accountant undertaking work in financial accounting and reporting and identify appropriate action.

2 Single entity financial statements

Candidates will be able to prepare and present financial statements from accounting data for single entities, whether organised in corporate or in other forms, in conformity with IFRS requirements and explain the application of IFRS to specified single entity scenarios.

In the assessment, candidates may be required to:

a. identify the laws and regulations, and accounting standards and other requirements applicable to the statutory financial statements of an entity
b. calculate from financial and other data the amounts to be included in an entity's financial statements according to the international financial reporting framework
c. prepare and present the financial statements, or extracts therefrom, of an entity according to its accounting policies and appropriate international financial reporting standards
d. explain the application of IFRS to specified single entity scenarios
e. explain the principal differences between IFRS and UK GAAP and prepare simple extracts from single entity financial statements in accordance with UK GAAP
f. define and calculate from information provided the distributable profits of an entity
g. identify the circumstances in which the use of IFRS, and International Public Sector Accounting Standards (IPSASs) for not-for-profit entities might be required
h. calculate from financial and other data the amounts to be included in the equity section of the statement of financial position of a not-for-profit entity in accordance with its accounting policies and the appropriate financial reporting framework.

3 Consolidated financial statements

Candidates will be able to identify the circumstances in which entities are required to present consolidated financial statements, prepare and present them in conformity with IFRS and explain the application of IFRS to specified group scenarios.

In the assessment, candidates may be required to:

a. identify and describe the circumstances in which an entity is required to prepare and present consolidated financial statements
b. identify the laws and regulations, and accounting standards and other requirements applicable to the legal entity and consolidated financial statements of an entity
c. identify from financial and other data any subsidiary, associate or joint venture of an entity according to the international financial reporting framework
d. calculate from financial and other data the amounts to be included in an entity's consolidated financial statements in respect of its new, continuing and discontinued interests in subsidiaries, associates and jointly controlled operations (excluding partial disposals of subsidiaries and disposals of associates or jointly controlled operations) according to the international financial reporting framework
e. prepare and present the consolidated financial statements, or extracts therefrom, of an entity in accordance with its accounting policies and the international financial reporting framework, using calculated amounts and other information
f. explain the application of IFRS to specified group scenarios
g. explain the principal differences between IFRS and UK GAAP and prepare simple extracts from consolidated financial statements in accordance with UK GAAP.

TECHNICAL KNOWLEDGE

The tables contained in this section show the technical knowledge in the disciplines of financial reporting, audit and assurance, business analysis, ethics and taxation covered in the ACA syllabus by module.

For each individual standard the level of knowledge required in the relevant Certificate and Professional Level module and at the Advanced Level is shown.

The knowledge levels are defined as follows:

Level D

An awareness of the scope of the standard.

Level C

A general knowledge with a basic understanding of the subject matter and training in its application thereof sufficient to identify significant issues and evaluate their potential implications or impact.

Level B

A working knowledge with a broad understanding of the subject matter and a level of experience in the application thereof sufficient to apply the subject matter in straightforward circumstances.

Level A

A thorough knowledge with a solid understanding of the subject matter and experience in the application thereof sufficient to exercise reasonable professional judgement in the application of the subject matter in those circumstances generally encountered by Chartered Accountants.

Key to other symbols:

→ the knowledge level reached is assumed to be continued

FINANCIAL REPORTING

Topic	Certificate & Professional Level		Advanced Level
	Accounting	Financial Accounting and Reporting	Corporate Reporting
Preface to International Financial Reporting Standards		A	A
Conceptual Framework for Financial Reporting	B	A	A
IAS 1 Presentation of Financial Statements	A	A	A
IAS 2 Inventories	B	A	A
IAS 7 Statement of Cash flows	B	A	A
IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors	B	A	A
IAS 10 Events after the Reporting Period		A	A
IAS 11 Construction Contracts			A
IAS 12 Income Taxes		C	A
IAS 16 Property, Plant and Equipment	B	A	A
IAS 17 Leases		B	A
IAS 18 Revenue	C	A	A
IAS 19 Employee Benefits			A
IAS 20 Accounting for Government Grants and Disclosure of Government Assistance		A	A
IAS 21 The Effects of Changes in Foreign Exchange Rates		C	A
IAS 23 Borrowing Costs		C	A
IAS 24 Related Party Disclosures		B	A
IAS 26 Accounting and Reporting by Retirement Benefit Plans		-	D
IAS 27 Separate Financial Statements		B	A
IAS 28 Investments in Associates and Joint Ventures		B	A
IAS 29 Financial Reporting in Hyperinflationary Economics			D
IAS 32 Financial Instruments: Presentation		B	A
IAS 33 Earnings Per Share		C	A
IAS 34 Interim Financial Reporting			A
IAS 36 Impairment of Assets		B	A
IAS 37 Provisions, Contingent Liabilities and Contingent Assets	C	A	A
IAS 38 Intangible Assets	C	A	A
IAS 39 Financial Instruments: Recognition and Measurement		C	A
IAS 40 Investment Property		-	A
IAS 41 Agriculture		-	D
IFRS 1 First-Time Adoption of IFRS		-	A

Topic	Certificate & Professional Level		Advanced Level
	Accounting	Financial Accounting and Reporting	Corporate Reporting
IFRS 2 Share-based Payment		-	A
IFRS 3 Business Combinations		B	A
IFRS 4 Insurance Contracts		-	D
IFRS 5 Non-Current Assets Held for Sale and Discontinued Operations		B	A
IFRS 6 Exploration for and Evaluation of Mineral Resources		-	D
IFRS 7 Financial Instruments: Disclosures		B	A
IFRS 8 Operating Segments		-	A
IFRS 9 Financial Instruments		-	C
IFRS for SMEs		-	A
IFRS 10 Consolidated Financial Statements		B	A
IFRS 11 Joint Arrangements		B	A
IFRS 12 Disclosure of Interests in Other Entities		B	A
IFRS 13 Fair Value Measurement		C	A

DIFFERENCES BETWEEN IFRS AND UK GAAP

The following table identifies the scope of the differences examinable in the ACA qualification and where they will be introduced. In general, the differences will become examinable where the relevant IFRS is set at knowledge level 'A'. The differences may also be examined in subsequent modules but only in a different context, for example at the Advanced Level where knowledge of the differences forms part of an integrated question. Where a general awareness only of an accounting standard is expected (knowledge level 'D') any differences will also be dealt with at this level.

1.

Title	Key *examinable differences* between IFRS and UK GAAP
Preface to International Financial Reporting Standards	No examinable differences.
Conceptual Framework for Financial Reporting	ASB Statement of Principles for Financial Reporting • Qualitative characteristics are based on the IASB Framework rather than the revised chapters that form part of the new Conceptual Framework • Includes chapters on the reporting entity, presentation and accounting for interests in other entities where there is no direct equivalent in the Conceptual Framework • Measurement chapter is more detailed with an emphasis on the 'deprival value model'.
IAS1 Presentation of Financial Statements	Companies Act • Format 1 and 2 profit & loss account classifications of expenses are similar to IAS1. However, IAS1 requires further detail, but not necessarily as individual line items in the statement of comprehensive income. • CA balance sheet formats are less flexible than IAS1 formats that allow a wider choice of classification formats. • Differences in terminology used, including a balance sheet which is described as a statement of financial position under IAS 1. FRS3 Reporting Financial Performance • Specifies certain 'mezzanine' exceptional items that must be presented on the face of the profit & loss account after operating profit. IAS1 doesn't specify items and doesn't contain the strict "concept" of exceptional items. • Requires separate presentation of profit & loss account and STRGL. IAS1 allows a single statement of profit and loss and comprehensive income which combines both.

	• Requires a sub-total for operating profit which is not explicitly required by IAS1. FRS18 Accounting Policies • The disclosure requirements for estimation techniques are not as extensive. FRS18 only requires a discussion of significant estimation techniques. FRS28 Corresponding Amounts • Does not specifically require comparative information for narrative and descriptive information to be disclosed.
IAS2 Inventories	SSAP9 Stocks and Long Term Contracts • No examinable differences.
IAS7 Statement of Cash Flows	FRS1 Cash Flow Statements • Allows certain exemptions from preparing a cash flow statement for certain subsidiaries and small companies. No exemptions in IAS7. • The definition of cash is more restrictive and only includes cash and deposits repayable on demand (within 24 hours). IAS7 uses the wider terminology of 'cash and cash equivalents". • Cash flows are classified under eight standard headings rather than three. There is less flexibility as to where certain cash flows, such as interest paid, are presented.
IAS8 Accounting Policies, Changes in Accounting Estimates and Errors	FRS3 Reporting Financial Performance • Comparative financial information is restated where a fundamental prior period error has occurred which is more restrictive than IAS 8 which requires restatement for material prior period errors. FRS18 Accounting Policies • Impending changes to accounting policies are not required to be disclosed. FRS28 Corresponding Amounts • No examinable differences.
IAS10 Events after the Reporting Period	FRS21 Events After the Balance Sheet Date • No examinable differences.

IAS11 Construction Contracts	SSAP9 Stocks and Long-Term Contracts • Unlike IAS11, service contracts may fall within its scope. • Requires the asset representing the gross amount due from customers for contract work to be split between amounts recoverable on contracts (debtors) and long-term contract balances (stocks). • Inequalities in profit generation from different stages of a contract should be considered in determining the attributable profit. IAS11 is silent on this.
IAS12 Income Taxes	FRS19 Deferred tax • Requires deferred taxation to be recognised on the basis of timing differences rather than IAS12's temporary differences. • May require deferred taxation to be recognised at a different rate than IAS12 for intra-group transactions eliminated on consolidation. • FRS19 permits, but does not require, the discounting of deferred tax balances, whereas IAS12 prohibits this. • FRS 19 does not normally recognise deferred taxation on the revaluation of assets.
IAS16 Property, Plant and Equipment	FRS15 Tangible Fixed Assets • Where assets have been revalued FRS15 requires the use of existing use value (EUV) rather than fair value. • FRS15 specifies a maximum period of five years between full valuations and an interim valuation every three years. IAS16 does not specify a maximum period and the timing of revaluations depends on changes in market values. • FRS15 requires impairment losses to be debited first against any revaluation surplus in respect of the asset unless it reflects a consumption of economic benefits. IAS16 does not include such a limitation. • The residual values of assets are assessed at the date of acquisition and not adjusted for expected future price changes. However, residual values should be reviewed at each balance sheet date and revised if appropriate. IAS16 requires them to be reassessed at the end of each reporting period taking into account current price changes. This may affect the depreciation expense. • Annual impairment reviews are required for all assets, which are either depreciated over a period of more than 50 years or not depreciated. IAS16 does not include such a requirement.
IAS17 Leases	SSAP21 Accounting For Leases and Hire Purchase Contracts • SSAP21 contains the "90% test" rebuttable presumption for determining the classification of finance and operating leases. • IAS17 specifically requires leases of land and buildings to be split at inception as a separate lease of the land and a separate lease of the buildings. Under SSAP21 they are considered together.

	• The net cash investment method is used for lessor accounting. IAS17 requires the net investment method. • UK GAAP requires operating lease rental incentives to be spread over the shorter of the lease term and the period until the next rent review. IAS requires any incentives to be spread over the whole lease term.
IAS18 Revenue	There is no comprehensive UK accounting standard covering revenue. The main principles in FRS 5 Reporting the Substance of Transactions and IAS 18 are consistent.
IAS19 Employee Benefits	FRS17 Retirement Benefits • The scope of IAS19 is wider and covers different types of employee compensation. • IAS19 allows a similar immediate recognition approach to actuarial gains and losses as FRS17. • Deferred tax balances are netted off the net pension scheme asset\liability under FRS17. Under IAS19 they must be shown separately.
IAS20 Accounting for Government Grants and Disclosure of Government Assistance	Companies Act • There are no examinable differences.
IAS21 The Effects of Change in Foreign Exchange Rates	FRS23 The Effects of Changes in Foreign Exchange Rates • No examinable differences.
IAS23 Borrowing Costs	FRS15 Tangible Fixed Assets • FRS 15 allows the option for borrowing costs to be capitalised and this is a choice of accounting policy. IAS 23 requires directly attributable costs, including borrowing costs, to form part of the cost of the asset. • FRS 15 limits the capitalisation of borrowing costs to the finance costs incurred on the expenditure incurred. IAS23 limits the amount to the borrowing costs on the total related funds raised less the investment income from any temporary investment of those funds.
IAS24 Related Party Disclosures	FRS8 Related Party Disclosures • Unlike IAS24, parent company's individual financial statements are exempt from providing disclosures when consolidated financial statements are presented. • Unlike IAS24, wholly owned UK subsidiaries are exempt from disclosing transactions with the parent entity.

	• Disclosure requirements differ. In general FRS8 requires the disclosure of the name of the related party where a transaction has occurred whereas IAS24 does not. • Management compensation disclosures are included in CA rather than FRS8 as well as disclosures on loans and other transactions involving directors. • IAS24 does not consider the materiality of related party transactions. FRS8 considers materiality from the perspective of both the company and the related party.
IAS26 Accounting and Reporting by Retirement Benefit Plans	• No examinable differences.
IAS27 Separate Financial Statements	FRS2 Accounting for Subsidiary Undertakings FRS9 Associates and Joint Ventures • No examinable differences.
IAS28 Investments in Associates and Joint Ventures	FRS9 Associates and Joint Ventures • Prescribes detailed format for equity accounting. IAS 28 does not prescribe guidance for the statement of comprehensive income. However, IAS1 provides limited guidance which uses a pre-tax presentation of the associate's income. FRS9 shows the components separately. • Requires investors to recognise their share of any interest in net liabilities. IAS28 only requires this where there is a legal or constructive obligation to make good those losses.
IAS29 Financial Reporting in Hyperinflationary Economies	FRS24 Financial Reporting in Hyperinflationary Environments • No examinable differences.
IAS32 Financial Instruments: Presentation	FRS25 Financial Instruments: Disclosure and Presentation • No examinable differences.
IAS33 Earnings per Share	FRS22 Earnings Per Share • No examinable differences.
IAS34 Interim Financial	

Reporting	No UK accounting standard on interim financial reporting. IAS34 is broadly comparable with the ASB statement on interim reports.
IAS36 Impairment of Assets	FRS11 Impairment of fixed assets and goodwill • Impairment losses on previously revalued assets are taken to the profit & loss account where they relate to a consumption of economic benefits (see IAS16\FRS15 above). • Impairment losses are allocated to goodwill, intangible assets and tangible assets in that order. IAS36 allocates the losses to goodwill first and then on a pro-rata basis to intangible and tangible assets. • FRS11 is more restrictive on the recognition of the reversal of intangible assets other than goodwill. • Unlike IAS36, where cash flows have been used to demonstrate the recoverable amount, FRS11 requires future cash flows to be monitored against those forecasts for the 5 subsequent years (look back test).
IAS37 Provisions, Contingent Liabilities and Contingent Assets	FRS12 Provisions, Contingent Liabilities and Contingent Assets • No examinable differences
IAS38 Intangible Assets	SSAP13 Accounting for Research and Development • The capitalisation of development expenditure is optional. IAS38 requires it to be capitalised where it meets the recognition criteria. • Development expenditure recognition criteria include a requirement to have a reasonable expectation of future benefits. IAS38 is more stringent as the requirement is to demonstrate future benefits. FRS10 Goodwill and Intangible Assets • Only intangible assets that can be sold separately from the business are recognised under UK GAAP. IAS38 allows non-separable assets to be recognised where they arise from contractual or other legal rights. • Allows amortisation of intangibles over economic life or no amortisation where an indefinite life is assessed. Under IAS38 goodwill and indefinite life assets should not be amortised but instead tested annually for impairment.
IAS39 Financial Instruments: Recognition and Measurement	FRS26 Financial Instruments: Measurement • No examinable differences.
IAS40 Investment Property	SSAP19 Accounting for Investment Properties • Requires measurement at open market value. IAS40 allows a choice between cost and fair value.

	• Investment gains and losses are taken to STRGL unless they represent a permanent deficit in fair value. Under IAS40 all gains and losses are recognised in profit or loss.
IAS41 Agriculture	No equivalent UK accounting standard.
IFRS1 First-Time Adoption of IFRS	Not applicable – not relevant to UK GAAP.
IFRS2 Share-based Payment	FRS20 Share-based Payment • No examinable differences
IFRS3 Business Combinations	FRS6 Acquisitions and Mergers • Merger accounting is required when criteria are met. Not permitted under IFRS. • Group reconstructions are merger accounted for (AS). • Common control transactions are not within scope of IFRS3 (AS). • IFRS3 contains explicit option (not in UK GAAP) to measure minority interest (or non-controlling interest (NCI)) as fair value. FRS7 Fair Values in Acquisition Accounting • Provides specific guidance on fair value measurement. IFRS3 only offers brief guidance on fair value measurement. • Only requires separable intangible assets to be fair valued. Hence, more intangibles could be recognised under IFRS3. • Requires acquisition-related costs to be included in the cost of the investment. IFRS3 requires them to be treated as period costs. • Post-acquisition changes to the estimates of contingent consideration affect the amounts of goodwill recognised. IFRS3 permits few subsequent changes to be reflected in goodwill. FRS10 Goodwill and Intangible Assets • Goodwill is often amortised over its estimated useful economic life. There is a rebuttable presumption that it is not more than 20 years. IFRS3 prohibits amortisation and requires annual impairment reviews. • Negative goodwill is capitalised as a separate item within goodwill and amortised over the period over which any related losses are expected and as acquired non-monetary assets are realised. IFRS3 requires immediate recognition as a gain in the profit and loss account.

IFRS4 Insurance Contracts	Companies Act • Contains specific requirements for insurance companies. Specific requirements in SORP and FRS27, Life Assurance.
IFRS5 Non-current Assets Held for Sale and Discontinued Operations	FRS3 Reporting Financial Performance • Continuing and discontinued activities must be analysed. Unlike IFRS5 detailed analysis is shown on face of the profit and loss account. • Discontinued classification will often be at a later date than IFRS5 as disposal must be completed during the reporting period or before the earlier of the approval of the financial statements and three months after year-end. FRS15 Tangible Fixed Assets • Classification and measurement of assets generally continues as normal without regard for the disposal. This includes depreciation until the date of disposal. IFRS5 on the other hand requires depreciation to cease while a non-current asset is held for sale. FRS1 Cash flow Statements • Encourages the separate disclosure of cash flows from discontinued operations. This is required rather than encouraged by IFRS5.
IFRS6 Exploration for and Evaluation of Mineral Resources	SORP discusses the issues surrounding oil and gas exploration and production.
IFRS7 Financial Instruments: Disclosures	FRS29 Financial Instruments: Disclosures • No examinable differences
IFRS8 Operating Segments	SSAP25 Segmental Reporting • Omission of segment information is allowed where disclosure may be seriously prejudicial to the entity's interests. No exemption exists under IFRS8. • Requires disclosures for both geographic and business segments. IFRS8 requires disclosure about the components of the entity that management uses to make decisions about operating matters. • Requires segment information to be prepared in accordance with accounting policies. IFRS8 requires the amounts reported to be on the same basis as for internal decision making. • SSAP25 does not require unlisted subsidiaries of listed parents to disclose segment information where the

	parent has prepared such information.
IFRS9 Financial Instruments	FRS26 Financial Instruments: Measurement • No examinable differences
IFRS10 Consolidated Financial Statements	FRS2 Accounting for Subsidiary Undertakings • Includes an exclusion of a subsidiary from consolidation on the grounds of severe long-term restrictions. No exemption exists under IFRS10. • IFRS10 links power to control, no such discussion exists in FRS2 • Under IFRS10 the existence of potential voting rights should be considered in assessing power. No consideration is required under UK GAAP • Requires the non-controlling interest to be presented separately from shareholders' funds. IFRS10 requires it to be shown as a separate component of equity • IFRS10 requires changes in a parent's ownership interest in a subsidiary following a loss of control to be measured at its fair value at the date when control is lost. FRS2 does not require this.
IFRS11 Joint Arrangements	FRS9 Associates and Joint Ventures • Requires the use of the gross equity method rather than the equity method required by IFRS11.
IFRS12 Disclosure of interests in Other Equities	FRS2 Accounting for Subsidiary Undertakings FRS9 Associates and Joint Ventures • No examinable differences.
IFRS13 Fair Value Measurement	No equivalent UK accounting standard.

IFRS in individual company accounts.

Candidates may be required to discuss the key issues that need to be considered when considering whether UK companies should retain UK GAAP for their individual company accounts or to move to IFRS. This is examinable in the Financial Accounting and Reporting module.

ETHICS CODES AND STANDARDS

Ethics Codes and Standards	Level	Certificate and Professional Level modules
IESBA Code of Ethics for Professional Accountants (parts A, B and C and Definitions)	A	Assurance Business and Finance Law Management Information Principles of Taxation
ICAEW Code of Ethics	A	Audit and Assurance Business Strategy Financial Accounting and Reporting Financial Management Tax Compliance Business Planning: Taxation
APB FRC Ethical Standards 1-5 (revised) Provisions Available for Small Entities (revised)	A	Assurance Audit and Assurance