



Strategic Business Reporting (SBR) (INT/UK)

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Strategic Business Reporting (SBR-INT/UK)

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CONCEPTUAL AND REGULATORY FRAMEWORK

Chapter 1

IASB CONCEPTUAL FRAMEWORK

The IASB Framework provides the underlying rules, conventions and definitions that underpin the preparation of all financial statements prepared under International Financial Reporting Standards (IFRS).

- Ensures standards developed within a conceptual framework
- Provide guidance on areas where no standard exists
- Aids process to improve existing standards
- Ensures financial statements contain information that is useful to users
- Helps prevent creative accounting

The revised IASB Conceptual Framework was issued in March 2018 and the **new** areas included are as follows:

- Measurement basis
- Presentation and disclosure
- Derecognition

Whilst **updates** have been made to the following:

- Definitions of assets/liabilities
- Recognition of assets/liabilities

And **clarification** on:

- Measurement uncertainty
- Prudence
- Stewardship
- Substance over form



1. Objective of financial reporting

'Provide information that is useful to existing and potential investors, lenders and other creditors in making **decisions** about providing resources to the entity'

The decisions made by **users** will involve:

- Investment decisions
- Financing decisions
- Voting, or influencing management actions

The users will be assessing the management's stewardship of the entity alongside its prospects for the future, which will require the following information:

- Economic resources of the entity
- Claims against the entity
- Changes in the entity's economic resources and claims.
- Efficiency and effectiveness of management

2. Qualitative characteristics – make information useful

Fundamental qualitative characteristics

- Relevance – information that makes a difference to decisions made by users (nature and materiality)
- Faithful information – must faithfully represent the substance of what it represents, and is therefore complete (helps understand and includes descriptions and explanations), neutral (no bias, and therefore supported by the exercise of prudence) and free from error. Measurement uncertainty will impact the level of faithful representation.

Enhancing qualitative characteristics

- Comparability – identify similarities/differences between entities and year-on-year
- Verifiability – assures the information represents the economic phenomena it represents
- Timeliness – information is less useful the longer it takes to report it
- Understandability – user have a reasonable knowledge of business and activities

A cost constraint applies in ensuring that the information is useful, in that the benefit of obtaining the information should outweigh the cost of obtaining it.



3. Financial statements and the reporting entity

Reporting entity

Is the entity that is required to prepare financial statements and does not necessarily have to be a legal entity.

Financial statements

Report the entities assets, liabilities, income and expenses for:

- Consolidated financial statements
- Un-consolidated financial statements
- Combined financial statements
 - Prepared for the entity as a whole
 - Entity is a going concern and will continue to do so

4. Elements of financial statements

- **Assets**
 - Present economic resource
 - Controlled
 - Past events
- **Liabilities**
 - Present obligation
 - Transfer an economic resource
 - Past event
- **Equity**
 - Residual interest in assets less liabilities
- **Income**
 - Increase in asset
 - Reduction in liability
- **Expense**
 - Reduction in asset
 - Increase in liability

5. Recognition and derecognition

Recognition – the process of including an item in the financial statements and is appropriate if it results in relevant and faithful representation

Derecognition – the removal of all or part of an asset (loss of control)/liability (no obligation)



6. Measurement

Historical cost

Price of the transaction that gave rise to the item

Current value

Provides updated information to reflect conditions at the measurement date

- Fair value
- Value in use (assets)/Fulfilment value (liabilities)
- Current cost

7. Presentation and disclosure

Statement of profit or loss is the primary source of information for a company's performance, which includes all income and expense. If the income and expense arises from changes in current value then it can be recognised through other comprehensive income.

Reclassification of other comprehensive to profit or loss is allowable if it gives more relevant information.

8. Capital maintenance

- Financial capital maintenance
- Operating (physical) capital maintenance

Example 1 - Framework

The following accounting standards were examined in F7 Financial Reporting:

- IAS 2 Inventories
- IAS 16 Property, plant and equipment
- IAS 37 Provisions, contingent assets and contingent liabilities
- IAS 38 Intangibles

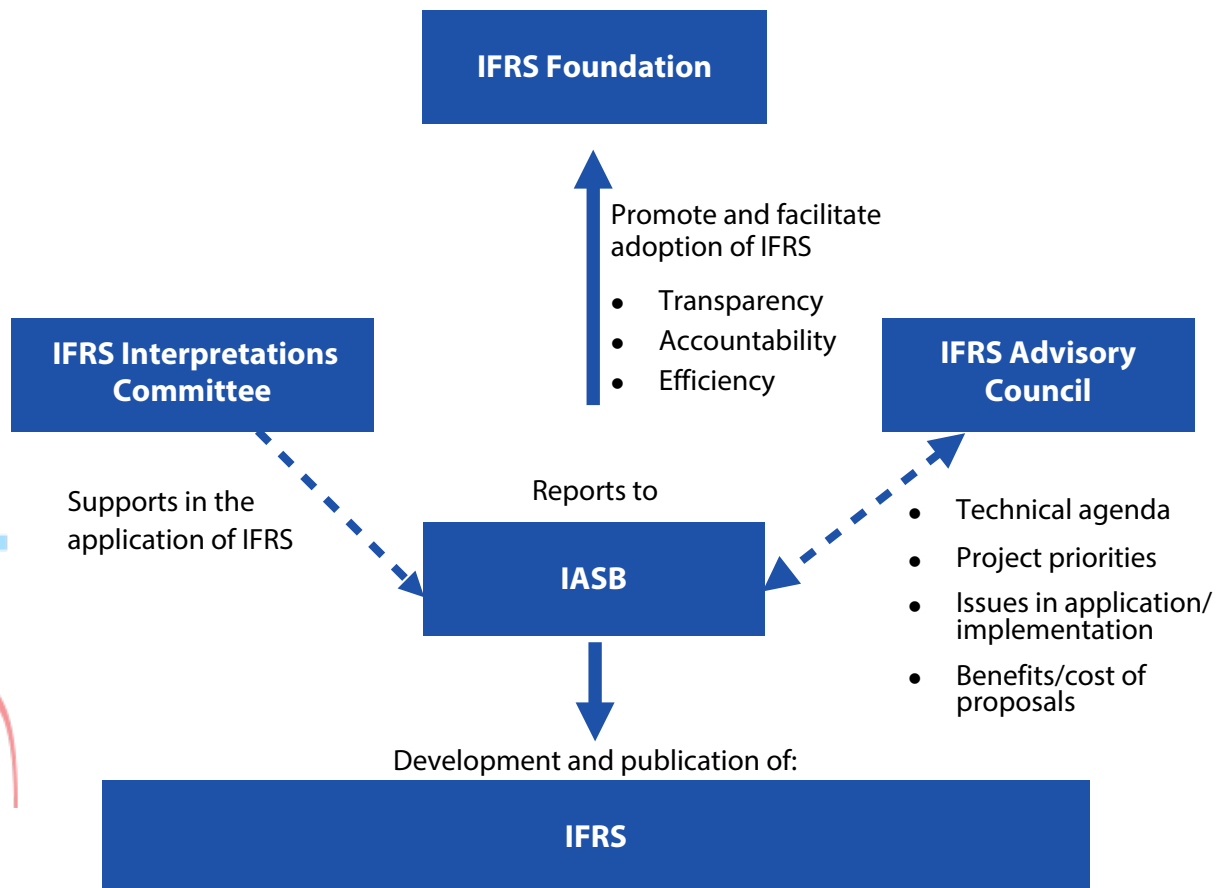
Apply the principles outlined in the IASB Framework to the accounting standards above.



Chapter 2

REGULATORY FRAMEWORK

A regulatory framework exists to ensure that the accounting standards are prepared to meet the needs of users.



<http://www.ifrs.org/about-us/who-we-are/>

Example 1 - Regulatory Framework

Which one of the following is a duty of the IFRS Interpretations Committee?

- A To provide guidance on financial reporting issues not specifically addressed in IFRSs
- B To develop and approve IFRSs
- C To gather views that supplement the normal consultative process
- D To promote the use and rigorous application of IFRSs



Example 2 – Regulatory bodies

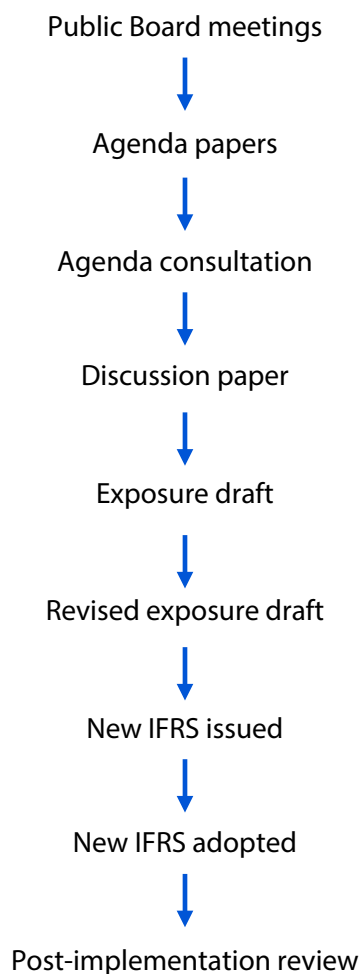
Which one of the following would NOT be regarded as a responsibility of the IASB?

- A Responsible for all IFRS technical matters
- B Publish IFRSs
- C Overall supervisory body of the IFRS organisations
- D Final approval of interpretations by the IFRS Interpretations Committee

1. IASB work plan

Technical projects (e.g. revenue/leases/financial instruments) are all set out in the work plan (<http://www.ifrs.org/projects/work-plan/>), however it does not include just standard setting projects. It also includes research (evidence gathering) and maintenance (narrow scope amendments and interpretations) projects.

2. Standard setting process



PUBLISHED COMPANY ACCOUNTS

Chapter 3

PRESENTATION OF FINANCIAL STATEMENTS (IAS 1)

Financial statements will present to the users of accounts:

- Statement of financial position
- Statement of profit or loss and other comprehensive income
- Statement of changes in equity
- Statement of cash flows
- Notes to the accounts
- Comparatives

Financial statements should provide a fair presentation of the results, which is achieved by compliance with IFRSs.



Statement of financial position as at [date]

	\$'000s	\$'000s
ASSETS		
Non-current assets		
Property, plant and equipment		X
Intangibles		X
Financial assets		X
		X
Current assets		
Inventories	X	
Trade and other receivables	X	
Financial assets	X	
Cash and cash equivalents	X	
	X	
Non-current assets held for sale	X	
		X
Total assets		X
EQUITY AND LIABILITIES		
Equity		
Equity shares (\$1)		X
Retained earnings		X
Other components of equity		X
Total equity		X
Non-current liabilities		
Long term borrowings	X	
Finance lease liabilities	X	
Deferred tax	X	
Retirement benefit liability	X	
		X
Current liabilities		
Trade and other payables	X	
Dividends payable	X	
Tax payable	X	
Finance lease liabilities	X	
		X
Total equity and liabilities		X



Statement of profit and loss and other comprehensive income for the year ended [date]

Continuing operations	\$'000s
Revenue	X
Cost of sales	(X)
Gross profit	X
Distribution expenses	(X)
Administrative expenses	(X)
Operating profit	X
Finance costs	(X)
Investment income	X
Profit before tax	X
Income tax expense	(X)
Profit from continuing operations for the period	X
Discontinued operations	
Profit/(loss) for the period from discontinued operations	X
Profit/(loss) for the period	X
Other comprehensive income for the year (after tax):	
Items that will not be reclassified to profit or loss:	
Gain on non-current asset revaluations	X
Gain/(loss) on fair value through other comprehensive income investment	X/(X)
Re-measurement gain/(loss) on defined benefit plan	X/(X)
	X
Items that may be reclassified subsequently to profit or loss:	
Ineffective element of gain/(loss) on cash flow hedge	X/(X)
Exchange difference on translation of foreign subsidiary	X/(X)
Other comprehensive income, net of tax	X
Total comprehensive income for the period	X

Statement of changes in equity for the year ended [date]

	Equity shares	Retained earnings	Other components of equity	Total
	\$'000s	\$'000s	\$'000s	\$'000s
B/f	X	X	X	X
Issue of share capital	X	-	-	X
Dividends	-	(X)	(X)	(X)
Total comprehensive income for the year	-	X	X	X
Transfer to retained earnings	-	X	(X)	-
C/f	X	X	X	X



GROUP ACCOUNTS

Chapter 4

BASIC GROUP STRUCTURES

1. Subsidiary

A subsidiary is an entity that is controlled by another entity (parent).

An entity has control over an entity when it has the power to direct the activities, which is assumed to be when the entity has > 50% of the voting rights.

The parent company must prepare consolidated financial statement if it has control over one or more subsidiaries.

The underlying principles of consolidation are:

- Substance over legal form
- Control and ownership

Other situation where control exists are when the investor:

- Can exercise the majority of the voting rights in the investee
- Is in a contractual arrangement with others giving control
- Holds < 50% of the voting rights, but the remainder are widely distributed
- Holds potential voting rights which will give control

2. Associate

An associate is where an entity has significant influence over the associated company.

Significant influence is the power to participate in the financial and operating policy decisions. It is presumed that an investment of between 20% and 50% indicates the ability to significantly influence the investee.

Other situations where significant influence exists are when the investor:

- Representation on the board
- Participation in policy making process
- Material transaction between the two entities
- Interchange of managerial personnel
- Provision of essential technical information



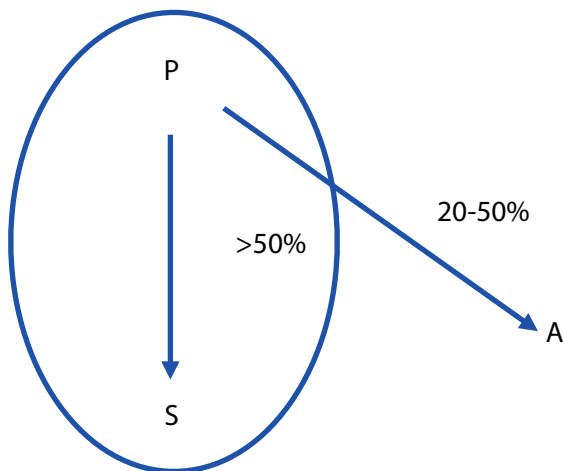
Example 1 – Influence

Vader acquired 19.9% of the equity share capital of Ren at the start of the financial year. As part of the investment Vader has two out of the eight seats on the board of directors.

Advise Vader how it should account for the investment in Ren in its financial statements.

3. Consolidated statement of financial position

W1) Group Structure



W2) Net assets of subsidiary

	<i>At reporting date</i>	<i>At acquisition</i>	<i>Post acquisition</i>
Equity shares	X	X	
SP	X	X	
Ret. earnings	X	X	
PUP (W) – S seller	(X)		
FV adjustments	X/(X)	X/(X)	
	X	X	X

W3) Goodwill

FV of consideration (shares/cash/loan stock)	X
NCI at acquisition (FV)	X
	X
FV of net assets at acquisition (W2)	(X)
Goodwill at acquisition (full)	X
Less: impairments to date	(X)
Goodwill (carrying value)	X

W4) Non-controlling interests

NCI @ acq ⁿ (W3)	X
Add: NCI% x S's post-acq ⁿ profits (W2)	X
Less: NCI% x impairment to date (W3)	(X)
	X

W5) Group retained earnings

100% P	X
Add: P's % of S's post acq ⁿ retained earnings (P's% x (W2))	X
Add: P's % of A's post acq ⁿ retained earnings (P's% x (W6))	X
Less: P's% x impairment to date in subsidiary (W3)	(X)
Less: Impairment to date (associate) (W6)	(X)
Less: PUP (P seller)	(X)
	X

W6) Investment in associate

Cost	X
Add: P% x A's post-acq ⁿ profits	X
Less: Impairment to date (100%)	(X)
	X

4. Adjustments – group and subsidiary

Intra-company balances

- Remove the payable
- Remove the receivable

Cash in transit

Step 1 Deal with cash in transit first (adjust receiver's books to assume they have recorded the cash)

Step 2 Remove the intra-company trade receivable and payable

Inventory in transit

Dr Inventory (SFP) X

Cr Payables (SFP) X



Unrealised profits**Inventory PUP**

Need to remove the intra-group profit included in inventory held @ year-end (cost structures)

Cr Inventory (SFP)	X
Dr Retained earnings (of seller)	X

- If S is seller → Adjust (W2)
- If P is seller → Adjust (W5)

Non-current asset PUP

Need to remove the intra group profit on intra -company transfers of non-current assets

Cr PPE (CSFP)	X
Dr Retained earnings (of seller)	X

- If S is seller → Adjust (W2)
- If P is seller → Adjust (W5)

Fair value adjustments (IFRS 3)

- Bring in FV of identifiable assets and liabilities on a line by line basis into the group SFP (PPE, inventory, contingent liabilities)
- Adjust S's net assets (W2) @ SFP date and @ acquisition column.
- Adjust S's net assets (W2) @ acqn column (extra depn, sale of inventory)



5. Other issues

Cost of investment

- Cash
 - now (@ price paid/share)
 - deferred (@PV)
 - contingent (@FV)
- Shares
 - # S shares acquired
 - # P shares issued
 - Value the P shares (@P's share price)
 - Record the share issue

• Mid-year acquisitions

Calculate the subsidiary's retained earnings at acquisition, assuming subsidiary profits in the year accrue evenly.

• Uniform accounting policies

Subsidiary must adopt the parents accounting policies in the group accounts. Accounted for by adjusting the value of assets/liabilities and (W2).

• Coterminous year-ends

Financial statements within three months of the parents year-end can be used and adjusted for any significant events.

• Non-consolidation

Subsidiaries are not consolidated if it is:

- Held for sale in accordance with IFRS 5 and
- Operating under long-term restrictions such that the parent company cannot exercise control



6. Adjustments - group and associate

Trading transactions – do not eliminate the balances

Unrealised profits – adjust for P's% of any PUP

Example 2 – Basic consolidation (revision)

Rey, a public limited company, operates in the manufacturing sector.

The draft statements of financial position at 31 December 2015 are as follows:

	<i>Rey</i> \$m	<i>Finn</i> \$m
Assets:		
Non-current assets		
Property, plant and equipment	1,560	1,250
Investments	1,540	
	<hr/> 3,100	<hr/> 1,250
Current assets:		
Inventory	450	580
Receivables	380	390
Cash	190	230
	<hr/> 1,020	<hr/> 1,200
Total assets	<hr/> 4,120	<hr/> 2,450
Equity and liabilities:		
Share capital	1,700	1,000
Retained earning	1,450	800
Total equity	<hr/> 3,150	<hr/> 1,800
Non-current liabilities	520	350
Current liabilities		
Trade payable	300	190
Tax payable	150	110
	<hr/> 450	<hr/> 300
Total liabilities	<hr/> 970	<hr/> 650
Total equity and liabilities	<hr/> 4,120	<hr/> 2,450

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

On 1 January 2014, Rey acquired 70% of the equity interest of Finn for a cash consideration of \$1,340 million. At 1 January 2014, the identifiable net assets of Finn had a fair value of \$1,850 million, and retained earnings were \$450 million. The excess in fair value is due to an item of property, plant and equipment that has a remaining useful life of 10 years.

It is the group policy to measure the non-controlling interest at acquisition at its proportionate share of the fair value of the subsidiary's net assets.

On 1 July 2015, Rey acquired 25% of the equity interest of Ben for a cash consideration of \$200 million. Ben's profits for the year were \$80 million, out of which a dividend of \$20 million was declared on 31 December 2015. The 25% holding gives Rey the power to participate in the operating and financing decisions of Ben.

Prepare the group consolidated statement of financial position of Rey as at 31 December 2015.



7. Other components of equity

Other components of equity is an additional reserve that constitutes any reserve that does not go into retained earnings. It could therefore include share premium, revaluation reserve, gains/losses on fair value through other comprehensive income investments.

In the group accounts it is treated in exactly the same way as the group retained earnings, i.e. 100% P plus P's% x S's post acquisition movement.

Example 3 – Other components of equity

Luke, a public limited company, operates in the manufacturing sector. The draft statements of financial position at 31 December 2015 are as follows:

	Luke \$m	Han \$m
Assets:		
Non-current assets		
Property, plant and equipment	3,650	2,480
Investment in Han	5,400	
	<u>9,050</u>	<u>2,480</u>
Current assets:		
Inventory	1,950	1,480
Receivables	1,780	1,090
Cash	370	285
	<u>4,100</u>	<u>2,855</u>
Total assets	<u>13,150</u>	<u>5,335</u>
Equity and liabilities:		
Share capital	5,500	2,000
Retained earning	3,200	1,000
Other components of equity	1,000	625
Total equity	<u>9,700</u>	<u>3,625</u>
Non-current liabilities	500	240
Current liabilities		
Trade payable	1,900	1,020
Tax payable	1,050	450
	<u>2,950</u>	<u>1,470</u>
Total liabilities	<u>3,450</u>	<u>1,710</u>
Total equity and liabilities	<u>13,150</u>	<u>5,335</u>

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

- On 1 January 2015, Luke acquired 80% of the equity interest of Han for a cash consideration of \$5,400 million. At 1 January 2015, the identifiable net assets of Han had a fair value of \$3,400 million, and retained earnings were \$600 million and other components of equity were \$400 million. The excess in fair value is due to an item of non-depreciable land.
- The fair value of the non-controlling interest at the date of acquisition was \$700m.

- Calculate the goodwill using (i) the proportionate share of net assets method, and (ii) the fair value method.
- Calculate the group retained earnings and group other components of equity.



Consolidated statement of profit and loss and other comprehensive income**X/12**

	<i>P</i>	<i>S</i>	<i>Adj.</i>	<i>Group</i>
Revenue	X	X	(X)	X
COS	(X)	(X)	X	
-PUP (Inventory)	(X)	(X)		(X)
-FV adj (extra dep ⁿ)		(X)		
Gross profit				X
Dist costs	(X)	(X)		(X)
Admin exp.	(X)	(X)		
-Impairment		(X)		(X)
Finance cost	(X)	(X)	X	(X)
Investment income	X	X	(X)	X
-Dividend from S/A	(X)			
Associate (P's % x A's PFY) - impairment				X
Profit before tax				X
Taxation	(X)	(X)		(X)
PFY		X		X
Revaluation gain	X	X		X
Associate				X
TCI		X		X
		Parent (β)		X
		NCI = NCI% x S's TCI		X



Example 4 – Group SPLOCI (revision)

	<i>Vader</i> \$m	<i>Maul</i> \$m
Revenue	1,645	1,280
Cost of sales	(1,205)	(990)
Gross profit	440	290
Distribution costs	(100)	(70)
Administrative expenses	(90)	(50)
Profit before interest and tax	250	170
Finance costs	(55)	(30)
Profit before tax	195	140
Taxation	(35)	(28)
Profit for the year	160	112
Revaluation gain	100	50
Total comprehensive income	260	162

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

On 1 July 2015, Vader acquired 80% of the equity shares of Maul, a public limited company, for a cash consideration of \$90 million. The fair value of the identifiable net assets acquired was \$85 million and the fair value of the non-controlling interest was \$25 million. The fair value of the net assets at acquisition was not materially different to their book value.

On 1 January 2015 Vader acquired 25% of the equity shares of Sith and exerted significant influence through its representation on the board of directors. Sith's profits for the year were \$100 million.

It is the group policy to measure the non-controlling interest at acquisition at fair value.

Goodwill has been impairment tested at year-end and found to have fallen in value by 20% in Vader. Goodwill impairments are recorded in administrative expenses.

Vader sold goods to Maul for \$20 million at fair value following the acquisition. Vader made a loss on the transaction of \$5 million and none of the goods sold had been sold outside of the group by year-end.

Maul revalued its land and buildings at the year-end and recorded a revaluation surplus of \$50 million through other comprehensive income.

No dividends were declared by any company during the year.

Assume that profits accrue evenly during the year.

Prepare a consolidated statement of profit or loss for the Vader group for the year-ended 31 December 2015



8. Disclosure of interest in other entities (IFRS 12)

IFRS 12 requires that a parent discloses the significant assumptions and judgement used in determining whether control exists over an investee.

The parent will therefore list all the entities it has a relationship with and explain the basis of the accounting treatment.

9. Impairments and group accounts

An asset/CGU is impaired if the carrying amount is greater than the recoverable amount.

The recoverable amount is the **higher** of the value in use and the fair value less costs to sell.

Impairment – Subsidiary (full goodwill)

The subsidiary is treated as a cash generating unit, where the carrying value is that of the subsidiary plus any goodwill.

Example 5 – Subsidiary impairment (full goodwill)

Dublin acquired 60% of the equity share capital of Fairyhouse on 1 January 2015 for \$20million. The fair value of the identifiable net assets at that date was \$25million and the fair value of the non-controlling interest was \$15million.

Fairyhouse made profits for the year-ended 31 December 2015 of \$5million. Its value in use was calculated as \$38million and is fair value less costs to sell as \$36million.

Calculate the impairment in the subsidiary to be recognised in the group financial statements of Dublin as at 31 December 2015.

In the example above if the goodwill is measured under the full goodwill method then the impairment is split between the parent and the NCI based upon the ownership percentages as the goodwill consists of the parent's goodwill and NCI goodwill. The journal entry would be as follows:

DR Retained earnings (W5) – P's % of the impairment

DR NCI (W4) – NCIs % of the impairment

CR Goodwill (W3) – 100% of the impairment

Impairment – subsidiary (partial goodwill)

If goodwill is measured using the proportionate share method the goodwill calculated consists of the partial goodwill (P's share) and the impairment is allocated entirely to the group retained earnings as there is no NCI share of goodwill.

The calculation of the impairment becomes slightly more complex as the carrying value of the subsidiary needs to reflect the net assets of the subsidiary plus the full goodwill, as the recoverable amount used is that of the entire subsidiary. The issue is that the goodwill figure reflects the partial goodwill, i.e. only the parent's share and not the full goodwill, so the partial goodwill will therefore need to be grossed up to an equivalent full goodwill amount so that the impairment is calculated on the full value of the subsidiary (S's net assets plus grossed up goodwill). This carrying value can then be compared to the recoverable amount as normal to calculate the impairment.



Illustration – Subsidiary impairment (partial goodwill)

Belfast acquired 80% of the equity share capital of Dundalk on 1 January 2018 for \$60 million. The fair value of the identifiable net asset at that date was \$40 million and goodwill is measured using the proportionate share method.

Goodwill is therefore calculated as follows:

	<i>\$ million</i>
Fair value of consideration	60
NCI at acquisition	8
Net assets at acquisition	(40)
Goodwill at acquisition	28

Dundalk made profits for the year-ended 31 December 2018 of \$10 million and the annual impairment review revealed the recoverable amount to be \$45 million.

The subsidiary is impaired if the carrying value of the subsidiary is greater than the recoverable amount. The carrying value of the subsidiary will be equal to the net assets at the reporting date plus the grossed-up goodwill, using the ownership percentages.

Net assets at reporting date = Net assets at acquisition + profit for the year
 \$40 million + \$10 million
 \$50 million

Grossed-up goodwill = Partial goodwill (80%) + NCI goodwill (20%)
 \$28 million + (20/80 x \$28 million)
 \$35 million

Carrying value = \$85 million

The subsidiary is therefore impaired by \$40 million (\$85 million - \$45 million), of which \$7 million relates to the NCI and cannot be processed as an adjustment as the NCI goodwill has not been recognised in the group accounts. The impairment that is left to be recognised is therefore \$33 million (\$40 million - \$7 million) and is allocated first to goodwill and the remainder to the net assets as follows:

DR	Group profit or loss	\$33 million
CR	Goodwill	\$28 million
CR	S's net assets	\$5 million



Impairment – Associate

The associate is treated as an asset, where the value of the asset is the value of the investment in associate.

Example 6 – Associate impairment

Cork acquired 25% of the equity share capital of Navan on 1 January 2015 for \$5million and exerts significant influence over it. Navan made profits for the year-ended 31 December 2015 of \$2million and did not declare any dividends during the year.

Cork impairment tested Navan at the end of the year, whereby the fair value less costs to sell were \$16million and the value in use was \$20m.

Calculate the value of Navan to appear in the Cork group consolidated statement of financial position at 31 December 2015.

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Chapter 5

JOINT ARRANGEMENTS (IFRS 11)

A joint arrangement is an arrangement where two or more parties have joint control over an entity under a contractual agreement.

- Joint venture
- Joint operation

Joint venture

A joint venture is whereby the parties have rights to the net assets of the arrangement. A separate entity is created and each of the venturers hold shares in the new entity.

The accounting for the arrangement is done using equity accounting.

Joint operation

A joint operation is whereby the parties have rights to the assets and obligations to the liabilities of the arrangement

The accounting for the arrangement is done by each party recording their share of the arrangements assets and liabilities in their own statement of financial position and their share of revenue and costs in their own statement of profit or loss.

Example 1 – Joint operation

Lyon has a 40% share of a joint operation, a natural gas station. The following information relates to the joint arrangement activities:

- The natural gas station cost \$15 million to construct and was completed on 1 January 2015. Its useful life is estimated at 10 years.
- In the year, gas with a direct cost of \$22 million was sold for \$30 million. Additionally, the joint arrangement incurred operating costs of \$1.5 million during the year.
- Assets, liabilities, revenue and costs are apportioned on the basis of the shareholding.

Lyon has only contributed and accounted for its share of the construction cost, paying \$6 million. The revenue and costs are receivable and payable by the other joint operator who settles amounts outstanding with Lyon after the year-end (31 December 2015)

Show how Lyon would account for the above in its consolidated financial statements for the year ended 31 December 2015.





Chapter 6

CHANGES IN GROUP STRUCTURE

A group structure can change if the parent company either buys more shares in an entity or sells shares of an entity.

1. Step acquisition

An investment in an entity will, in practice, be bought in stages over a period of time

No control -> control

The accounting treatment is to treat the original investment as being disposed of at fair value and re-acquired at fair value. The fair value on re-acquisition plus the extra consideration paid for the additional new shares bought, becomes the cost of the increased investment.

1. Re-measure original investment to fair value and gain to profit or loss
2. Calculate goodwill

(W) Goodwill

	\$m
Cost of additional investment	X
Fair value of existing interest	X
NCI at acquisition	X
Fair value of S's net assets at acquisition	(X)
Goodwill at acquisition	<u>X</u>

Example 1

Jeremy acquired 40% of the equity interest of David for \$40 million several year ago. On the 1 January 2015, Jeremy acquired an additional 35% for \$45 million when the fair value of the identifiable net assets were \$105 million.

The fair value of the non-controlling interest on 1 January 2015 was \$32 million the fair value of the original 40% holding was \$52 million.

Calculate the goodwill to appear in the Jeremy group statement of financial position as at 31 December 2015.



Control -> control (change in ownership)

We are buying the appropriate part of the NCI's entitlement to the subsidiary's net assets, including goodwill.

An increase in ownership resulting in a reduction in non-controlling interest. Transfer from the non-controlling interest.

DR	NCI	X
DR	Retained earnings	X
CR	Bank	X

As we have not acquired a subsidiary, there is no gain or loss to be calculated, it is just a transfer between owners.

Example 2

Continuing from example 1.

On 31 December 2015, Jeremy acquired a further 5% of David for \$8 million. David had made profits since being acquired by Jeremy of \$10 million. There has been no impairment of goodwill.

Prepare the journal entry to record the change in ownership from a 75% holding to an 80% holding.



3. Step disposals

Control -> control (change in ownership)

A decrease in ownership resulting in an increase in non-controlling interest. Transfer to the non-controlling interest.

DR	Bank	X
CR	Non-controlling interest	X
CR	Retained earnings	X

Example 3

Betty owned 70% of the equity shares of Penny before it then sold 10% of the subsidiary on 31 December 2015 for \$40 million.

The net assets at the date of disposal of the shares was \$350 million and the goodwill on acquisition of the original 90% holding was \$50 million.

Prepare the journal entry to record the change in ownership from a 70% holding to a 60% holding.

Control -> no control

Calculate a group profit or loss on disposal of the subsidiary.

(W) Group profit/loss on disposal

	\$m
Proceeds	X
Add: investment still held	X
Add: non-controlling interest	X
Less: net assets at disposal	(X)
Less: goodwill	(X)
Group profit or loss on disposal	X

Example 4

Socks owned 90% of Mogs before it decided to sell a 50% stake of its investment on 31 December 2015 for \$120 million. The non-controlling interest at that date was \$53 million and the fair value of the remaining 40% is \$96 million.

The goodwill on acquisition of the original 90% holding was \$38 million and the net assets at the date of disposal were \$201 million.

Calculate the group profit on disposal that will appear in the group financial statements of Socks group for the year-ended 31 December 2015.



Example 5 – Group SFP

Reilly, a public limited company, operates in the manufacturing sector. The draft statements of financial position at 31 December 2015 are as follows:

	<i>Reilly</i> \$m	<i>Hulme</i> \$m	<i>Jones</i> \$m
Non-current assets	180	115	100
Investment in Hulme	90	-	-
Investment in Jones	85	-	-
Current assets	80	90	60
Total assets	<u>435</u>	<u>205</u>	<u>160</u>
Share capital	250	80	75
Retained earning	110	65	45
Other components of equity	10	-	-
Non-current liabilities	15	14	10
Current liabilities	50	46	30
Total equity and liabilities	<u>435</u>	<u>205</u>	<u>160</u>

The following information is relevant in preparing the group financial statements of the Reilly Group.

Reilly acquired a 60% holding in the equity shares of Hulme on 1 January 2014 for a cash consideration of \$75million, when the retained earnings were \$25 million. The fair value of the non-controlling interest was \$40 million.

On the 31 December 2015, Reilly acquired a further 10% of the equity shares of Hulme for a cash consideration of \$15million.

Reilly acquired a 90% of the equity shares of Jones on 1 January 2015 for a cash consideration of \$120 million when the retained earnings were \$35 million. The fair value of the non-controlling interest was \$13 million

On 31 December 2015, Reilly disposed of 20% of the equity shares in Jones for a cash consideration of \$35 million.

The group policy is to value the non-controlling interest at acquisition using the fair value method.

Calculate for inclusion in the consolidated statement of financial position of the Reilly Group as at 31 December 2015 the following balances (i) Goodwill, (ii) Non-controlling interests, and (iii) Group retained earnings.



Example 6 – Group SPL

	<i>Maryland</i> \$m	<i>Tansey</i> \$m
Revenue	2,468	1,664
Cost of sales	(1,808)	(1,287)
Gross profit	660	377
Other expenses	(285)	(156)
Profit before interest and tax	375	221
Finance costs	(83)	(39)
Profit before tax	292	182
Taxation	(53)	(36)
Profit for the year	239	146

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

Maryland acquired 75% of the equity share capital of Tansey on 1 January 2012. On 1 April 2015, Maryland disposed of a 10% holding in Tansey.

Calculate the non-controlling interest in the Maryland Group consolidated statement of profit and loss for the year ended 31 December 2015.

Example 7

Harry Co owns 90% of the shares in Matthew Co. Harry Co originally acquired 25% of the shares many years ago. Last year Harry Co acquired a further 55% to take its holding to 80%. In the current year Harry Co acquired a further 10% to take its holding to 90%.

Explain how the accounting treatment for Matthew Co should have been accounted for each time Harry acquired shares.





Chapter 7

FOREIGN CURRENCY (IAS 21)

1. Functional currency

Currency of the primary economic environment in which the entity operates. This is deemed to be where the entity generates and expends cash.

Management should consider the following factors in determining the functional currency:

- The currency that dominates the determination of the **sales prices**
- The currency that most influences **operating costs**
- The currency in which an **entity's finances** are denominated is also considered.

If an entity has transactions that are denominated in a currency other than its functional currency then the amount will need to be translated into the functional currency before it is recorded within the general ledger.

Individual company accounts

Record the transaction at the exchange rate in place on the date the transaction occurs.

Monetary assets and liabilities are retranslated using the closing rate at the reporting date, with any gains or losses going through profit or loss.

Non-monetary assets and liabilities are not retranslated at the reporting date, unless carried at fair value, whereby translate at the rate when fair value was established.

Note: No specific guidance is given as to where any exchange differences are recorded within profit or loss. The general accepted practice is:

- Trading transaction – operating costs
- Financing transaction – financing costs

Example 1

Jones Inc. has its functional currency as the \$USD.

It trades with several suppliers overseas and bought goods costing 400,000 Dinar on 1 December 2015. Jones paid for the goods on 10 January 2016.

Jones's year-end is 31 December. The exchange rates were as follows:

1 December 2015	4.1 Dinar : \$1USD
31 December 2015	4.3 Dinar : \$1USD
10 January 2016	4.4 Dinar : \$1USD

Show how the transaction would be recorded in Jones's financial statements.



Example 2

Flower Inc. acquired an item of property, plant and equipment on 1 January 2011 at cost of 72 million dinars. The property is depreciated straight-line over 20 years, with nil residual value. At 31 December 2015, the property was revalued to 95 million dinars. The following exchange rates are relevant to the preparation of the financial statements:

1 January 2011	3.6 Dinar : \$1USD
31 December 2015	4.3 Dinar : \$1USD

Show how the transaction would be recorded in Flower's financial statements for the year-ended 31 December 2015.

2. Group accounts

If a group has a subsidiary company that is located overseas, that subsidiary will have a different functional currency to the rest of the group. Before consolidation of the subsidiary its results will need to be correctly stated in its functional currency. Once this has been done the results can then be translated into the presentational currency of the group and consolidated.

Group SFP

- Translate all the assets and liabilities of the subsidiary @ closing rate (CR)
- Goodwill working in overseas currency and translate at the closing rate
- Calculate the exchange differences in the subsidiary.

	Rate	\$m
Non-current assets	@CR	X
Current assets	@CR	X
Non-current liabilities	@CR	(X)
Current liabilities	@CR	(X)
Net assets		X
Equity share capital	@HR	X
Reserves		
Pre-acquisition	@HR	X
Post-acquisition	(β)	X
Equity		X



Group P/L and OCI

Translate all the income and expenses of the subsidiary @ average rate (AR)

Example 3**Statements of profit or loss for the year-ended 31 December 2015**

	<i>Holly</i> \$m	<i>Ivy</i> Dinars m
Revenue	247	1,664
Cost of sales	(181)	(1,288)
Gross profit	66	376
Expenses	(29)	(156)
Profit before interest and tax	37	220
Finance costs	(8)	(40)
Profit before tax	31	180
Taxation	(5)	(50)
Profit for the year	26	130

Statements of financial position at 31 December 2015

	<i>Holly</i> \$m	<i>Ivy</i> Dinars m
Non-current assets	200	500
Investment in Ivy	200	-
Current assets	90	390
Total assets	490	890
Share capital	250	350
Retained earning	110	280
Non-current liabilities	80	65
Current liabilities	50	195
Total equity and liabilities	490	890

The following information is relevant to the preparation of the consolidated financial statements of Holly.

On 1 January 2015, Holly acquired 80% of the equity share capital of Ivy for a consideration of Dinars 760 million when the retained earnings were Dinars 150 million.

The non-controlling interest is valued using the proportionate share on net assets method.

The following exchange rates are relevant to the preparation of the financial statements:

	<i>Dinars to \$</i>
1 January 2015	3.8
31 December 2015	4.3
Average rate for the year to 31 December 2015	4.0

Calculate for inclusion in the group statement of financial position of the Holly Group at 31 December 2015 the following balances: (i) Goodwill, (ii) Post-acquisition reserves, (iii) Non-controlling interests, and (iv) Group retained earnings.



Gain or loss on translation of the overseas subsidiary

The subsidiary's financial statements are translated using different exchange rates, being the opening and closing rate for net assets and average rate for profit or loss items. This gives rise to exchange gains or losses each year as we translate the subsidiary at year-end.

			\$m
Opening net assets			
	@ OR	X	
	@ CR	X	
			X
Profit for the year			
	@ AR	X	
	@ CR	X	
			X
Goodwill			
	@ OR	X	
	@ CR	X	
			X
Translation gain/loss			<hr/> X

Any gains or losses on translation of the overseas subsidiary are recognised in other comprehensive income.

Example 4 – Gain or loss on translation of the overseas subsidiary

Continuing from the previous example, calculate the gain or loss on translation of the overseas subsidiary.



Example 5 – Foreign currency and extracts from the financial statements

Rory owns 70% of Noah, an overseas company and that prepares its financial statements in Dinar.

The following extracts have been obtained from the individual financial statements of Rory and Noah as at 31 December 20X8:

Rory	\$000
Retained earnings	64,210
Noah	Dinar'000
Total assets	39,750
Total liabilities	25,200

Rory acquired the shares in Noah for \$9.1 million on 1 January 20X6, when Noah had net assets with a carrying amount of Dinar 10.8 million. At this date, Noah also had an item of property with a fair value of Dinar 4 million in excess of its carrying amount with a remaining life of 10 years.

Rory value the non-controlling interest at fair value. At the date of acquisition this was valued at \$1.8 million.

Information from the individual statements of profit or loss for the year ended 31 December 20X8 showed that Rory recorded a loss for the year of \$1.4 million, while Noah showed a profit of Dinar 2.3 million.

Relevant exchange rates are as follows:

1 January 20X6	Dinar 3.2 = \$1
1 January 20X8	Dinar 3.9 = \$1
Average rate 20X8	Dinar 3.6 = \$1
31 December 20X8	Dinar 3.4 = \$1

Required:

- Calculate the goodwill, non-controlling interest and retained earnings to appear in the consolidated statement of financial position of the Hastings group as at 31 December 20X8
- Prepare extracts of the consolidated statement of profit or loss and other comprehensive income for the year ended 31 December 20X8





Chapter 8

GROUP STATEMENT OF CASH FLOWS

Consolidated statement of cash flows for the year ended [date]

	\$m	\$m
<i>Operating Activities</i>		
Group Profit Before Tax	X	
Depreciation	X	
Impairment	X	
Gain/Loss on Disposal of Tangibles	(X)/X	
Gain/Loss on Sale of Subsidiary	(X)/X	
Share of Associates Profit	(X)	
Interest Payable	X	
Inventory	(X)/X	
Receivables	(X)/X	
Payables	X/(X)	
Cash generated from operations	X	
Interest Paid	(X)	
Tax Paid	(X)	
<i>Cash generated from operating activities</i>		X
<i>Investing Activities</i>		
Sale Proceeds from Tangibles	X	
Purchase of Tangibles	(X)	
Dividend Received from Associate	X	
Acquisition/Disposal of Sub	(X)/X	
Dividends Received	X	
<i>Cash generated from investing activities</i>		X
<i>Financing Activities</i>		
Proceeds from Share Issue	X	
Loan Issue/Repayment	X/(X)	
Dividend paid to NCI	(X)	
Dividend paid to parent shareholders	(X)	
<i>Cash generated from financing activities</i>		X
Change in cash and cash equivalents		X/(X)
Opening cash and cash equivalents		X
Closing cash and cash equivalents		X



3. Dividend paid to the non-controlling interest

Non-controlling interest			
		B/f	X
Dividend paid (β)	X	Profit	X
Disposal of sub.	X	Acquisition of sub.	X
C/f	X		
	<u>X</u>		<u>X</u>

Example 1 – Dividend paid to non-controlling interest

Group statement of profit or loss for the year-ended 31 December 2015 (extract)

	\$m
Profit before tax	91
Taxation	(31)
Profit for the year	<u>60</u>

Attributable to:

Ordinary shareholders of the parent	54
Non-controlling interest	6

Group statement of financial position as at 31 December 2015 (extract)

	2015 \$m	2014 \$m
Equity		
Non-controlling interests	115	110

Calculate the dividend paid to the non-controlling interests to appear in the group statement of cash flows for the year-ended 31 December 2015.



4. Dividend received from associate

Associate			
B/f	X		
Profit	X	Dividend paid (β)	X
		C/f	X
	<u>X</u>		<u>X</u>

Example 2 – Dividend received from associate

Group statement of profit or loss for the year-ended 31 December 2015 (extract)

	<i>\$m</i>
Operating profit	83
Finance costs	(12)
Share of profit of associate	<u>20</u>
Profit before tax	91
Taxation	<u>(31)</u>
Profit for the year	<u>60</u>
Attributable to:	
Ordinary shareholders of the parent	54
Non-controlling interest	6

Group statement of financial position as at 31 December 2015 (extract)

	<i>2015</i> <i>\$m</i>	<i>2014</i> <i>\$m</i>
Assets		
Non-current assets		
Investment in associate	190	180

Calculate the dividend received from associate to appear in the group statement of cash flows for the year-ended 31 December 2015.



5. Acquisition/disposal of subsidiary

The acquisition or disposal of a subsidiary during the year is shown as a net cash outflow or inflow within investing activities to show the net cash paid to acquire the subsidiary or net cash received on disposal of a subsidiary.

An indirect adjustment is also required to adjust for any other balances (e.g. PPE, inventory, receivables, and payables) consolidated as part of the acquisition or disposed of as part of the disposal.

Working capital movement

	<i>Inventory</i>	<i>Receivables</i>	<i>Payables</i>
Opening	X	X	X
Acquisition/(disposal)	X/(X)	X/(X)	X/(X)
Expected	X	X	X
Closing (actual)	X	X	X
Movement	↑ or ↓	↑ or ↓	↑ or ↓

Example 3 – Acquisition of a subsidiary

Pablo Group statement of financial position as at 31 December 2015 (extract)

	<i>2015</i>	<i>2014</i>
	<i>\$m</i>	<i>\$m</i>
Non-current assets		
Property, plant and equipment	520	490
Current assets		
Inventory	145	195
Receivables	130	109
Cash and cash equivalents	50	75
Current liabilities		
Trade payables	85	70

The following information relates to the financial statements of the Pablo Group:

On 1 June 2015, Pablo acquired all of the share capital of Juan for \$50 million.

The fair value of the identifiable net assets and liabilities at the date of acquisition that have been reflected in the year-end balances of the Pablo Group are as follows:

	<i>\$m</i>
Property, plant and equipment	15
Inventory	8
Receivables	6
Cash and cash equivalents	5
Payables	(3)

Show how the above would be dealt with in the consolidated statement of cash flows for the year-ended 31 December 2015.



Example 4 – Group statement of cash flows

The following draft group financial statements relate to Dove, a public limited company.

Dove Group statement of financial position as at 31 December 2015

	2015 \$m	2014 \$m
Assets:		
Non-current assets		
Property, plant and equipment	1,745	1,250
Goodwill	1,184	1,230
Investment in associate	200	190
	<hr/> 3,129	<hr/> 2,670
Current assets:		
Inventory	530	580
Receivables	456	390
Cash and cash equivalents	190	230
	<hr/> 1,176	<hr/> 1,200
Total assets	<hr/> 4,305	<hr/> 3,870
Equity and liabilities:		
Share capital	1,700	1,500
Retained earning	1,060	900
	<hr/> 2,760	<hr/> 2,400
Non-controlling interest	575	540
	<hr/> 3,335	<hr/> 2,940
Non-current liabilities		
Long-term borrowings	300	200
Deferred tax	220	190
Current liabilities		
Trade payable	300	430
Current tax payable	150	110
	<hr/> 450	<hr/> 540
Total liabilities	<hr/> 970	<hr/> 930
Total equity and liabilities	<hr/> 4,305	<hr/> 3,870



Dove group statement of profit or loss for the year-ended 31 December 2015

	<i>\$m</i>
Revenue	1,765
Cost of sales	(1,185)
Gross profit	580
Distribution costs	(100)
Administrative expenses	(90)
Profit before interest and tax	390
Finance costs	(55)
Share of profit of associate	40
Profit before tax	375
Taxation	(95)
Profit for the year	280

Dove group statement of changes in equity for the year-ended 31 December 2015

	<i>Equity shares \$m</i>	<i>Retained earnings \$m</i>		<i>Non-controlling interest \$m</i>	<i>Total \$m</i>
B/f	1,500	900	2,400	540	2,940
Issue of share capital	200		200		200
Dividends		(65)	(65)	(20)	(85)
Total comprehensive income for the year		225	225	55	280
Transfer to retained earnings					
C/f	1,700	1,060	2,760	575	3,335

The following information relates to the financial statements of the Dove Group:

- On 1 June 2015, Dove acquired all of the share capital of Fred for \$50 million. The fair value of the identifiable net assets and liabilities at the date of acquisition that have been reflected in the year-end balances of the Dove Group are as follows:

	<i>\$m</i>
Property, plant and equipment	13
Inventory	20
Receivables	15
Cash and cash equivalents	3
Payables	(9)
	42

- Dove owns 20% of an associate. The associate made a profit for the year of \$200 million and paid a dividend of \$150 million.
- During the year Dove charged depreciation of \$130 million on its property, plant and equipment. It sold property, plant and equipment with a carrying value of \$43million for \$50 million

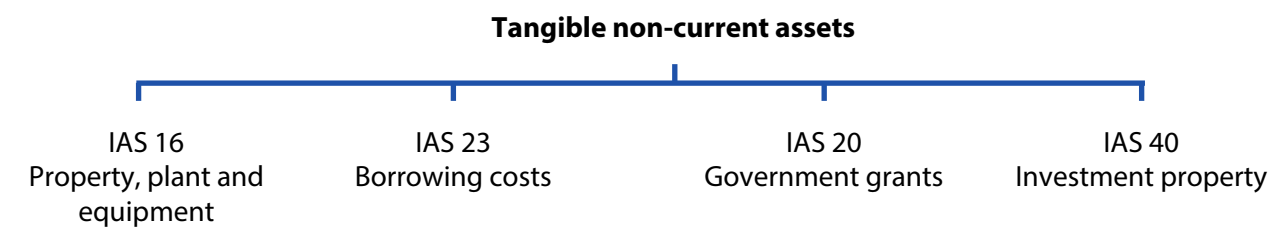
Calculate the following balances to be included in the Dove Group statement of cash flows for the year-ended 31 December 2015: (i) Cash generated from operations, (ii) Net cash paid to acquire the subsidiary, (iii) Dividend paid to the non-controlling interests, and (iv) Dividend received from the associate.



ACCOUNTING STANDARDS

Chapter 9

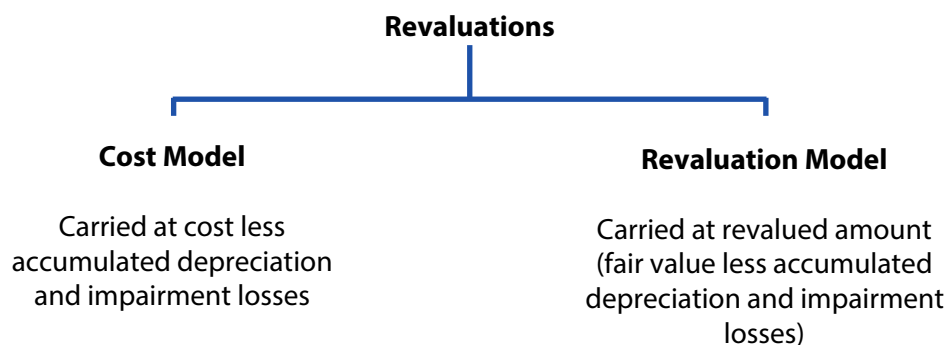
NON-CURRENT ASSETS



1. Property, plant and equipment (IAS 16)

Measurement at recognition

- At cost
 - Purchase price
 - Directly attributable costs in bringing asset to its location and condition
 - Costs to dismantle/restore (@ present value)



- Review periodically and keep revaluations up to date
- Consistent policy for each class of asset (avoids cherry-picking of assets)
- Revalue at open market value (i.e. value regardless of existing use)
- Depreciate the revalued asset less residual value over its remaining useful life



Example 1 – Revaluation increase

Panama bought an item of property, plant and equipment for \$80 million on 1 January 2012. The asset had zero residual value and was to be depreciated over its estimated useful life of 20 years.

On 1 January 2015 the asset was revalued to its fair value of \$95 million.

Calculate the amounts to shown in the financial statements of Panama for the year-ended 31 December 2015.

Example 2 – Revaluation decrease

On 1 January 2013, Panama purchased an item of property, plant and equipment for \$12 million. Panama uses the revaluation model to value its non-current assets. The asset has zero residual value and is being depreciated over its estimated useful life of 10 years. At 31 December 2014, the asset was revalued to \$14 million but at 31 December 2015, the value of the asset had fallen to \$8 million. Panama has not taken the effect of the revaluation at 31 December 2015 in its financial statements.

Calculate the amounts to shown in the financial statements of Panama for the year-ended 31 December 2015.

Specialised assets do not have a fair value as no market value is readily available as they are very rarely sold. In order to revalue a specialised asset, we need to use a depreciated replacement cost valuation.

Illustration – depreciated replacement cost

Peru owned a specialised item of PPE that had cost \$10 million. Its original useful life was 10 years and after 5 years when its carrying amount was \$5 million the replacement cost of the asset was \$15 million.

The depreciated replacement cost at this date is \$7.5 million, as the asset is halfway through its useful life ($\$15 \text{ million} \times 5 / 10$), and the asset is revalued from \$5 million to \$7.5 million to give a revaluation surplus in the year of \$2.5 million.



2. Depreciation

- Straight line
- Reducing balance

Depreciation starts when the asset is ready for its intended use and not from when it starts to be used.

Any change in estimate is applied prospectively by applying the new estimates to the carrying value of the PPE at the date of change.

Separate the cost into its component parts and depreciate separately if a complex asset.

Example 3 – Change in estimate

Ecuador bought an item of property, plant and equipment for \$25 million on 1 January 2012 and depreciated over its useful life of 10 years.

On 31 December 2014, the assets remaining life was estimated as 5 years.

Calculate the amounts to shown in the financial statements of Ecuador for the year-ended 31 December 2015.

3. Borrowing costs (IAS 23)

Borrowing costs, net of income received from the investment of the money borrowed, on a qualifying asset must be capitalised over the period of construction.

Capitalisation starts when:

- Expenditure on the asset commences
- Borrowing costs are being incurred
- Activities necessary to prepare the asset are in progress

Capitalisation must stop when the asset is ready for its use (whether or not it is being used) or when there is no active construction.

Capitalisation for specific borrowings is capitalised using the **effective rate** of interest.

Example 4 – Specific borrowings

Columbia commenced the construction of an item of property, plant and equipment on 1 March 2015 and funded it with a \$10 million loan. The rate of interest on the borrowings was 5%.

Due to a strike no construction took place between 1 October and 1 November.

Calculate the amount of interest to be capitalised as par to of non-current assets if Columbia's reporting date is 31 December 2015.



Example 5 – General borrowings

Venezuela had the following bank loans in issue during 2015.

	\$m
4% bank loan	25
3% bank loan	40

Venezuela commenced the construction of an item of property, plant and equipment on 1 January 2015 for which it used its existing borrowings. \$10 million of expenditure was used on 1 January and \$15 million was used on 1 July.

Calculate the amount of interest to be capitalised as part of the non-current assets.

4. Government grants (IAS 20)

Recognise the grant when the:

- Entity will comply with the conditions attached to the grant
- Entity will actually receive the grant

Grants should be recognised according to the deferred income approach, using a systematic basis. This spreads the income over the period in which the related expenditure is recognised.

If the grant is used to buy depreciating assets, the grant must be spread over the same life and using the same method.

Example 6 – Grants and depreciable assets

Tweddle bought an item of property, plant and equipment for \$10 million and received a government grant of \$2 million. The PPE has a useful life of 10 years and has no residual value.

Explain how the purchase of the property, plant and equipment and government grant would be dealt with in the financial statements of Tweddle.

Note: If a government grant becomes repayable, it is treated as a change in accounting estimate.

The payment is first shown against any remaining deferred income balance.

If the payment exceeds the deferred income balance then the excess payment is treated as an expense.



5. Investment properties (IAS 40)

Investment property is property (land or a building – or part of a building – or both) held to earn rentals or for capital appreciation or both, rather than for:

- Use in the production or supply of goods and services or for administrative purposes (IAS 16); or
- Sale in the ordinary course of business (IAS 2); or
- Future use as an investment property (IAS 16 until completed)

Initial measurement

Investment properties should initially be measured at cost plus directly attributable costs.

Subsequent measurement

Fair value model

- The investment properties are revalued to fair value at each reporting date
- Gains or losses on revaluation are recognised directly through profit or loss
- The properties are not depreciated

Cost model

- The investment properties are held using the benchmark method in IAS 16 (cost)
- The properties are depreciated like any other asset

Transfers into and out of investment property should only be made when supported by a change of use of the property.

- IP to owner occupied (IAS 16) – Fair value at date of change
- IP to inventory (IAS 2) – Fair value at date of transfer
- Owner occupied (IAS 16) to IP – Revalue under IAS 16 and then treat as IP
- Inventory (IAS 2) to IP – Fair value on change and gain/loss to profit or loss

Example 7– Investment property and change of use

Addlington owns a property that it is using as its head office. At 1 January 2015, its carrying value was \$20 million and its remaining useful life was 20 years. On 1 July 2015 the business was reorganised cheaper premises were found for use as a head office. It was therefore decided to lease the property under an operating lease.

The property was valued by a qualified professional, who assessed the property's value as \$21 million on 1 July and \$21.6 million on 31 December 2015.

Explain the accounting treatment of the property in the financial statements for the year-ended 31 December 2015.



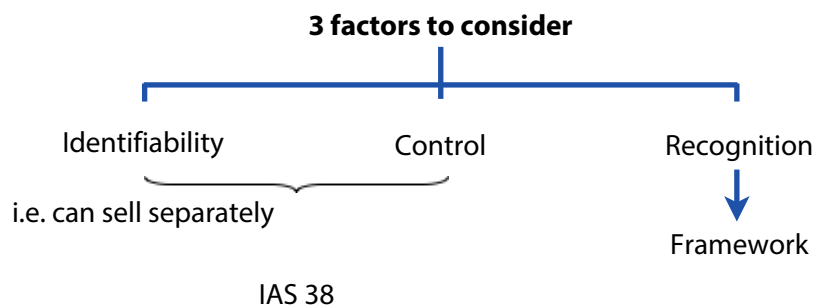


Chapter 10

INTANGIBLE ASSETS (IAS 38)

No physical substance but has value to the business.

- patents
- brand names
- licences



Separate acquisition

Capitalise at cost plus any directly attributable costs (e.g. legal fees, testing costs). Amortisation is charged over the useful life of the asset, starting when it is available for use.

Research

Research expenditure is charged immediately to profit or loss in the year in which it is incurred.

Development

Development expenditure must be capitalised when it meets all the criteria.

- Sell/use
- Commercially viable
- Technically feasible
- Resources to complete
- Measure cost reliably (expense)
- Probable future economic benefits (overall)

Internally generated

Internally generate brands, mastheads cannot be capitalised as their cost cannot be separated from the overall cost of developing the business.



Example 1 – Intangibles

Booker is involved in developing new products and has spent \$15 million on acquiring a patent to aid in this development. The initial investigative phase of the project cost an additional \$6 million, whereby it was determined that the future feasibility of the product was guaranteed.

Subsequent expenditure incurred on the product was \$8 million, of which \$5 million was spent on the functioning prototype and the remainder on getting the product into a safe and saleable condition.

A further \$1 million was spent on marketing and \$0.5 million on training sales staff on how to demonstrate the use of the product.

At the reporting date the product had not yet been completed.

Explain how Booker should account for the expenditure in its financial statements.



Chapter 11

IMPAIRMENTS (IAS 36)

1. Identify possible impairments (external vs. internal)
2. Perform impairment review (if identified possible impairments)
3. Record the impairment

1. Indicators of Impairment

External sources

- A significant decline in the asset's market value more than expected by normal use or passage of time
- A significant adverse change in the technological, economic or legal environment

Internal sources

- Obsolescence or physical damage
- Significant changes, in the period or expected, in the way the asset is being used e.g. asset becoming idle, plans for early disposal or discontinuing/ restructuring the operation where the asset is used
- Evidence that asset's economic performance will be worse than expected
- Operating losses or net cash outflows for the asset
- Loss of key employee

2. Impairment review

If the carrying value of the asset is greater than its recoverable amount, it is impaired and should be written down to its recoverable amount.

- **Recoverable amount** - the greater of fair value less cost to sell and value in use.
- **Fair value less costs to sell** - the amount receivable from the sale of the asset less the costs of disposal.
- **Value in use** - the present value of the future cash flows from the asset.

3. Record the impairment

Individual asset

The reduction in carrying value is taken through profit or loss unless related to a revalued asset, in which case it is taken to any revaluation surplus first.

Cash generating unit (CGU)

1. Specific assets
2. Goodwill
3. Remaining assets (pro-rata)



Example 1 – CGU impairment

Peter owned 100% of the equity share capital of Sharon, a wholly-owned subsidiary.

The assets at the reporting date of Sharon were as follows:

	\$'000
Goodwill	2,400
Buildings	6,000
Plant and equipment	5,200
Other intangibles	2,000
Receivables and cash	1,400
	<hr/>
	17,000

On the reporting date a fire within one of Sharon's buildings led to an impairment review being carried out.

The recoverable amount of the business was determined to be \$9.8 million. The fire destroyed some plant and equipment with a carrying value of \$1.2 million and there was no option but to scrap it.

The other intangibles consist of a licence to operate Sharon's plant and equipment. Following the scrapping of some of the plant and equipment a competitor offered to purchase the patent for \$1.5 million.

The receivable and cash are both stated at their realisable value and do not require impairment.

Show how the impairment loss in Sharon is allocated amongst the assets.

Note: Within a group of companies where there are several subsidiaries, the individual CGUs (subsidiaries) are tested for impairment first, before the overall value of the business is tested.



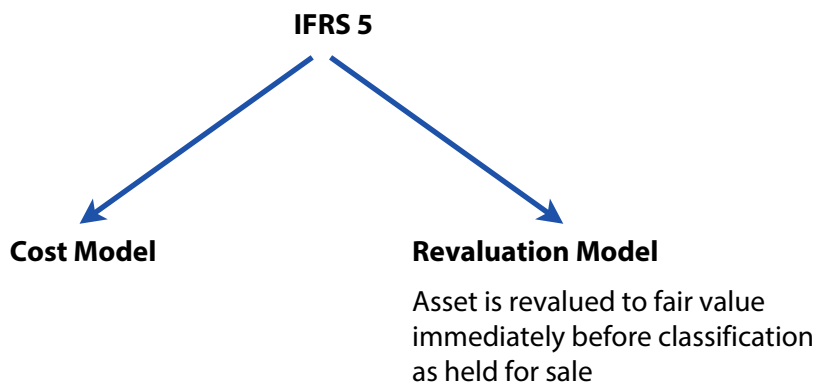
Chapter 12

NON-CURRENT ASSETS HELD FOR SALE AND DISCONTINUED OPERATIONS (IFRS 5)

1. Non-current assets held for sale

Must be available for immediate sale and sale must be highly probable (sell < 1 year, active programme to locate buyer, actively marketing).

Non-current asset held for sale is valued at the lower of the carrying value and fair value less costs to sell. Any reduction in value is recorded as an impairment through profit or loss.



- Once classified as a non-current asset held for sale it is no longer depreciated.
- The subsequent sale of the asset will give rise to a profit/loss on disposal.

Example 1 – NCA-HFS

At 1 January 2015, Namibia carried a property in its statement of financial position at its revalued amount of \$14 million in accordance with IAS 16 Property, Plant and Equipment. Depreciation is charged at \$300,000 per year on the straight line basis.

In April 2015, the management decided to sell the property and it was advertised for sale. By 30 April 2015, the sale was considered to be highly probable and the criteria for IFRS 5 Non-current Assets Held for Sale and Discontinued Operations were met at this date. At that date, the asset's fair value was \$15.4 million. Costs to sell the asset were estimated at \$300,000.

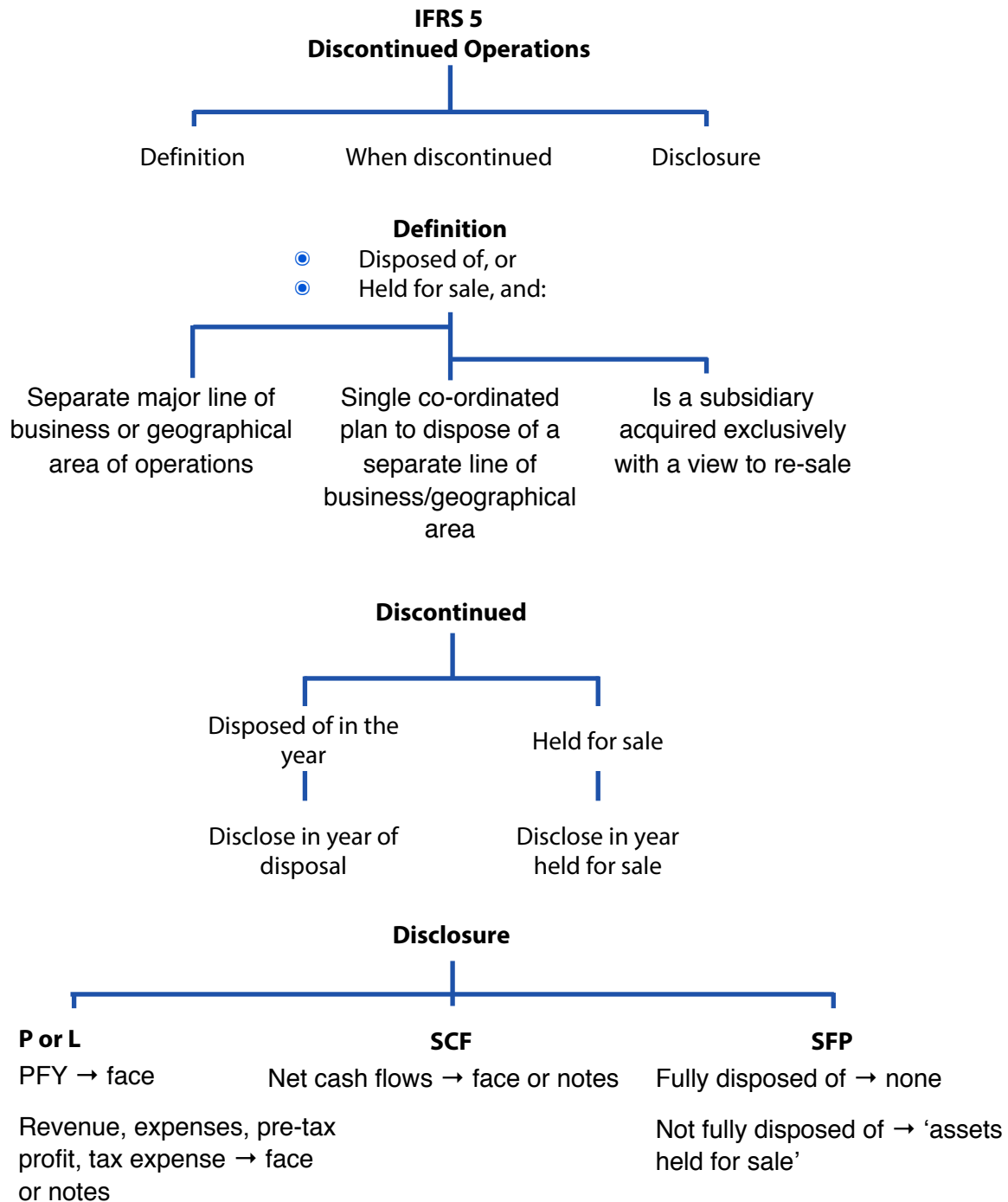
On 31 January 2016, the property was sold for \$15.6 million.

The transactions regarding the property are deemed to be material and no entries have been made in the financial statements regarding this property since 31 December 2014.

Explain how the above transaction should be dealt with in the financial statements of Namibia for the year-ended 31 December 2015.



2. Discontinued operations



Example 2 – Discontinued operations

Angola's car manufacturing operation has been making substantial losses. Following a meeting of the board of directors, it was decided to close down the car manufacturing operation on 31 March 2016. The company's reporting date is 31 December and the car manufacturing operation is treated as a separate operating segment.

Explain how the decision to close the car manufacturing operation should be treated in Angola's financial statements for the years ending 31 December 2015 and 2016.



Chapter 13

EMPLOYEE BENEFITS (IAS 19)

- Short-term benefits
- Long-term benefits

1. Pensions

Defined contribution scheme

Contributions are accrued in the financial statements with an expense recognised in profit or loss.

Defined benefit scheme

Statement of financial position (extract)

	\$m
Fair value of scheme assets	X
Fair value of scheme liabilities	(X)
Net pension asset/(liability)	X/(X)

Statement of profit or loss and other comprehensive income (extract)

	\$m
<i>Profit or loss</i>	
Operating costs	
Current service costs	(X)
Past service costs	(X)
Financing costs	
Interest expense	(X)
Return on investment	X
<i>Other comprehensive income</i>	
Re-measurement gain/(loss) (W)	X/(X)

Workings

Assets	\$m	Liabilities	\$m
Opening	X	Opening	X
Return on investment	X	Interest	X
Contributions paid in	X	Service costs	X
Benefits paid out	(X)	Benefits paid out	(X)
Expected	X	Expected	X
Re-measurement component (β)	X/(X)	Re-measurement component (β)	X/(X)
Closing (per actuary)	X	Closing (per actuary)	X



Example 1 – Defined benefit scheme

Finland operates a defined benefit pension scheme for all of its employees. The closing balances on the scheme assets and liabilities, at 31 December 2014, were \$60 million and \$64 million respectively.

Finland's actuary has provided the following information that has yet to be accounted for in the year-ended 31 December 2015.

	\$m
Current service cost	9
Past service cost	8
Contributions paid in	5
Benefits paid out	6
Fair value of plan asset	66
Fair value of plan liabilities	75
Yield on high quality corporate bonds	5%

Calculate the amounts that will appear in the financial statements of Finland for the year-ended 31 December 2015.

Curtailment

A curtailment occurs when there are a significant number of employees who leave the scheme, commonly seen if there is a re-organisation of the business or change in scheme from defined benefit to defined contribution.

The asset and liability are re-measured to fair value and any change is taken to profit or loss.

Example 2 – Curtailment

Flannagan announces the re-organisation of its business, resulting in the loss of jobs within the business.

The fair value of the plan assets and liabilities, immediately before the re-organisation, were \$48 million and \$60 million respectively.

The plan assets do not change following the curtailment but the pension liabilities are measured at \$55 million.

Explain the accounting treatment of the curtailment in the financial statements.

Asset ceiling

If a company has an overall pension asset on its statement of financial position then the asset can only be recognised up to the level of the asset ceiling. The asset ceiling is the present value of any future cash savings of not having to contribute to the scheme as it is in surplus. If the asset needs to be reduced to the asset ceiling limit then the reduction in the asset is shown as an expense in profit or loss.

Example 3 – Asset ceiling

Brannagan has a net pension asset in its statement of financial position of \$30 million. It therefore anticipates that it will not have to pay its usual contributions into the scheme for the next few years. It is estimated that the present value of the future reduction in contributions will be \$26 million.

Explain how the net pension asset will be treated in the financial statements.



Chapter 14

SHARE BASED PAYMENTS (IFRS 2)

1. Equity Settled

If the fair value of goods/services is known then this should be used in order to value the option, if the fair value of the goods/services is not known then the fair value of the option at the grant date should be used to value the options.

The fair value should be taken to profit or loss over the vesting period on a straight line basis, based on the number of options expected to be exercised. The corresponding credit entry will be recorded in equity reserves.

Example 1 – Fair value equity settled (services)

Brie granted 10,000 equity settled share based payments to its 20 directors on 1 January 2015. The options vest on 31 December 2017. It is anticipated that none of the directors will leave over the three year period. The fair value of the option is as follows:

	\$
1 January 2015	12.00
31 December 2015	13.50
31 December 2016	13.80
31 December 2017	14.20

Prepare the extracts to be shown in the statement of profit or loss and the statement of financial position for each of the three years ended 31 December 2015 to 31 December 2017.

Example 2 – Options expected to be exercised

On 1 January 2014, Edam granted 20,000 share options to each of its ten directors. The conditions attached to the share option scheme is that the directors must remain an employee of Edam for three years. The fair value of each equity settled share based payment at the grant date was \$60.

At 31 December 2014, it was estimated that four directors would leave before the end of the three years.

At 31 December 2015, due to a downturn in the economy, it was estimated that one director would leave before the end of the three years.

Prepare the extracts to be shown in the statement of profit or loss and the statement of financial position for the year ended 31 December 2014 and 31 December 2015.



Example 3 – Fair value equity settled (goods)

Caerphilly purchased inventory at a cost of \$10 million on 1 July 2015. The goods were sold in November 2015 for \$14 million.

Caerphilly had cash flow problems during 2015 and negotiated with its supplier to exchange the goods for options on its shares. The shares had a market value of £11.5 million on 1 July 2015.

Explain how the transaction should be dealt with in the financial statements for the year-ended 31 December 2015.

2. Cash settled

If the fair value of goods/services is known then this should be used in order to value the option, if the fair value of the goods/services is not known then the fair value of the option should be reassessed at each reporting date and this value should be used to value the options.

The fair value should be taken to profit or loss over the vesting period based on the number of options expected to be exercised. However as there will be a cash payment, the credit entry is recorded as a liability.

Example 4 – Fair value cash settled

Gouda granted 10,000 cash settled share based payments to its 20 directors on 1 January 2015. The options vest on 31 December 2017. It is anticipated that none of the directors will leave over the three year period. The fair value of the option is as follows:

	\$
1 January 2015	12.00
31 December 2015	13.50
31 December 2016	13.80
31 December 2017	14.20

Prepare the extracts to be shown in the statement of profit or loss and the statement of financial position for each of the three years ended 31 December 2015 to 31 December 2017.

Example 5 – Options expected to be exercised (cash settled)

On 1 January 2014, Cheddar granted 20,000 share appreciation rights to each of its ten directors. The conditions attached to the cash settled share based payment scheme is that the directors must remain an employee of Cheddar for three years. The fair value of each cash settled share based payment at the 31 December 2014 was \$80 and at 31 December 2015 was \$75.

At 31 December 2014, it was estimated that four directors would leave before the end of the three years.

At 31 December 2015, due to a downturn in the economy, it was estimated that two directors would leave before the end of the three years.

Prepare the extracts to be shown in the statement of profit or loss and the statement of financial position for the year ended 31 December 2014 and 31 December 2015.



3. Vesting conditions

Non-market based

- Conditions related to an employee having to remain with company for a fixed period or related to growth in profit or in earnings per share
- Non- market based vesting conditions are taken into account at each reporting period.

Market based

- Conditions related to the market price of the company's shares
- Market based vesting conditions are ignored for the purpose of estimating the number of options that will vest

Example 6 – Vesting conditions

Cheshire granted 5,000 share options to each of its five directors on 1 January 2015. The share options will vest on 31 December 2017 if the share price reaches \$15. It is not anticipated that any of the directors will leave during the three years.

The fair value of each option was \$12 at the grant date and the share price at 31 December 2015 was \$13. Due to the fall in global stock markets at the start of 2016, it is not anticipated that the share price will rise above its current price for the foreseeable future.

Explain the accounting treatment in the financial statements for the year ended 31 December 2015.

4. IFRS 2 – Scope

IFRS 2 applies where goods or services are received in exchange for an equity based payment; it does not apply to the following:

- Shares issued in a business combination
- Financial instrument contracts for the purchase of goods
- Purchase of treasury shares
- Rights issues where some of the shareholders are also employees.





Chapter 15

FINANCIAL INSTRUMENTS (IAS 32, IFRS 7 AND IFRS 9)

Company A

Financial asset

Purchase shares in co. B

Purchase co. B debt

Sells goods to B

Company B

Financial liability, or equity

Issues shares

Issues debt

Buys good from A

Example 1 – Equity or debt?

The investor has in issue two different classes of shares, being 'A' shares and 'B' shares. The 'A' shares are equity shares with voting rights attached and have been correctly classified as equity as there is no obligation to pay cash.

The 'B' shares are redeemable in three years' time and carry a nominal value of \$1 each.

The investor has a choice as to the following methods of redemption of the B shares:

- It may either redeem the 'B' shares for cash at their nominal value; or,
- It may issue one million 'A' shares in settlement.

'A' shares are currently valued at \$5 per share and the lowest 'A' share price has been is \$2 per share.

Discuss whether the 'B' shares should be treated as liabilities or equity in the financial statements.



1. Financial assets

Initial measurement

Initially recognise at fair value plus transaction costs, unless classified as fair value through profit or loss where transaction costs are immediately recognised through profit or loss.

Subsequent measurement

Equity instruments

Fair value through profit or loss (default)

Re-measure to fair value at the reporting date, with gains or losses through profit or loss.

Fair value through other comprehensive income

If there is a strategic intent to hold the asset the option to hold at fair value through other comprehensive income is available. Re-measure to fair value at reporting date, with gains or losses through other comprehensive income.

Debt instruments

Amortised cost

A financial asset is measured at amortised cost if it fulfils both of the following tests:

- ▶ Business model test – intent to hold the asset until its maturity date; and,
- ▶ Contractual cash flow test – contractual cash receipts on holding the asset.

If the contractual cash flow test is satisfied but there is no intention to hold the asset until maturity then the financial asset is held as fair value through other comprehensive income.

Note: The financial asset may still be measured using fair value through profit or loss, even if both tests are satisfied, if it eliminates an inconsistency in measurements (fair value option).



Derecognition

Financial assets are derecognised when sold, with gains or losses on disposal through profit or loss. Gains or losses previously recognised and held in other components of equity can be transferred to retained earnings in the statement of changes in equity.

Example 2 – Financial assets

Norman has the following financial assets during the financial year.

- Norman bought 100,000 shares in a listed entity on 1 November 2015. Each share cost \$5 to purchase and a fee of \$0.25 per share was paid as commission to a broker. The fair value of each share at 31 December 2015 was \$3.50.
- Norman bought 200,000 shares in a listed entity on 1 March 2015 for \$500,000, incurring transaction costs of £40,000. Norman acquired the shares as part of a long term strategy to realise the gains in the future. The fair value of the shares was £620,000 at 31 December. The shares were subsequently sold for \$650,000 on 31 January 2016.
- Norman bought 10,000 debentures at a 2% discount on the par value of \$100. The debentures are redeemable in four years' time at a premium of 5%. The coupon rate attached to the debentures is 4%. The effective rate of interest on the debenture is 5.71%.

Explain how each of the above financial assets will be accounted for in the financial statements.

2. Financial liabilities

Initial measurement

Initially recognise at fair value net of transaction costs ('net proceeds')

Subsequent measurement

- Amortised cost
- Fair value through profit or loss

Derecognition

- Financial liabilities are derecognised when they have been paid in full or transferred to another party.

Example 3 – Financial liabilities

Norma issues 20,000 redeemable debentures at their \$100 par value, incurring issue costs of \$100,000. The debentures are redeemable at a 5% premium in 4 years' time and carry a coupon rate of 2%. The effective rate on the debenture is 4.58%.

Calculate the amounts to be shown in the statement of financial position and statement of profit or loss for each of the four years of the debenture.



3. Convertible debentures

If a convertible instrument is issued, the economic substance is a combination of equity and liability and is accounted for using split equity accounting.

The liability element is calculated by discounting back the maximum possible amount of cash that will be repaid assuming that the conversion doesn't take place. The discount rate to be used is that of the interest rate on similar debt without and conversion option.

The equity element is the difference between the proceeds on issue and the initial liability element.

The liability element is subsequently measured at amortised cost, using the interest rate on similar debt without the conversion option as the effective rate. The equity element is not subsequently changed.

Issue costs associated with the issue are recognised by adjusting the effective rate of interest on the debenture.

Example 4 – Convertible debentures

Alice issued one million 4% convertible debentures at the start of the accounting year at par value of \$100 million, incurring issue costs of \$1 million.

The rate of interest on similar debt without the conversion option is 6%.

The impact of the issue costs increases the effective rate of interest on the debt to 6.34%

Explain how Alice should account for the convertible debenture in its financial statements for each of the three years.



4. Derivatives

A derivative financial instrument must have all three of the following characteristics:

- Its value changes in response to the change in a specified interest or exchange rate, or in response to the change in a price, rating, index or other variable;
- It requires no initial net investment;
- It is settled at a future date.

Derivative financial instruments should be recognised as either assets (favourable) or liabilities (unfavourable). They should be measured at fair value both upon initial recognition and subsequently, with any gains or losses through profit or loss.

Common examples of derivatives are:

- Forward contracts
- Interest rate swaps/FRA's
- Options

Illustration

Amy has taken out a \$10 million, 5-year, variable rate loan but is concerned that interest rates are going to rise in the next year or so. Amy has been advised to enter into an interest rate swap with a counter party which requires Amy to pay a fixed rate of 3% and receive a variable rate of LIBOR.

Amy pays or receives a net cash amount each year based on the difference between the 3% and LIBOR.

The interest rate swap is a derivative because:

- There is no initial net investment
- Settlement occurs at yearly intervals
- The underlying variable, LIBOR, changes with time

Note:

Some contracts may not meet the definition of a financial instrument, i.e. no financial asset or financial liability created, but they have the characteristics of a derivative and so are treated as a financial instrument.

A derivative's value changes due to the price of an underlying item so if an entity entered into a contract to purchase gold, and this purchase is not part of the entity's normal business, nor will delivery of the gold be taken but the settlement is in net cash (difference between the contract price and price on settlement) then the contract is treated as a financial instrument.



5. Impairment of financial assets

Impairment rules under IFRS 9 apply to investments in debt (loan assets) that are held at amortised cost or at fair value through other comprehensive income.

An expected credit loss model is used in an attempt to recognise credit losses before default occurs, and it uses a three stage model to recognise the loss incurred.

Expectations of credit losses

Credit losses recognised

Stage 1	Initial recognition and when no subsequent, significant deterioration in credit quality	PV of expected credit losses 12 months after reporting date (12 months expected credit losses)
Stage 2	Significant deterioration in credit quality	Impairment recognised at PV of expected credit shortfalls
Stage 3*	Objective evidence of an impairment	(Lifetime expected credit losses)

*The effective interest rate is applied to the carrying amount of the asset, net of any allowance, if there has been objective evidence of an impairment.

Illustration – Recognition of Stage 1 credit losses

On initial recognition the investor is required to assess the 12-month credit losses on its investments in debt. The credit loss is the difference between the cash received under the terms of the contract, and the cash expected to be received, discounted to present value.

Once the credit losses have been calculated, the 12-month expected credit losses are recognised, which are the lifetime credit losses multiplied by the probability of the issuer defaulting in the next 12-months.

If the lifetime expected credit losses are calculated as \$200,000, using a 5% discount factor, and the probability of default is estimated as being 2% in the next 12-months, then the 12-month expected credit losses are \$4,000 ($\$200,000 \times 2\%$). The \$4,000 is recorded within an allowance account and net against the value of the debt investment.

At the end of the first year, the 12-month expected credit loss is unwound. A year's worth of finance cost is recognised through profit or loss of \$200 ($\$4,000 \times 5\%$), alongside a corresponding increase in the loss allowance to \$4,200 ($\$4,000 + \200). The loss allowance continues to be net against the value of the debt investment.

Illustration – Recognition of Stage 2 credit losses

The credit losses are re-assessed if there is a significant change in the credit risk of the investment and this leads to the 12-month expected credit losses being updated to reflect the lifetime expected credit losses. Using the figures from the previous illustration, we would recognise the full \$200,000 lifetime expected credit losses.

Significant changes in credit risk is assumed if the cash receipt due is more than 30 days past its due date.



Illustration – Recognition of Stage 3 credit losses

Stage 3 occurs when there is objective evidence of an impairment, and the lifetime expected credit losses. The same lifetime expected credit losses would be applied as in the previous illustration, but the effective rate of interest on the investment would be applied to the net value of the debt investment, i.e. the figure after the deduction of the lifetime expected credit losses.

6. Hedging (IAS 39)

Companies have items on their statement of financial position that may change in value or may have highly likely future cash flows that may fluctuate. The changes in the value of these items give rise to additional risk in the business. Financial managers may therefore adopt a process of hedging to manage this risk.

- Hedged item – Exposed asset, liability or future cash flow
- Hedging instrument – Derivative designed to protect against fluctuations in value
- Hedged risk – Specific risk being hedged against (IFRS 7)

The hedge accounting treatment of the hedged item and hedging instrument depends on the type of hedge.

Fair value hedge

A fair value hedge aims to protect the fair value of an item already recognised in the financial statements. It usually addresses the fear that the value of the asset might fall whilst it is being held within the business.

- Gain or loss on the instrument is recognised through profit or loss
- Gain or loss on the hedged item also recognised through profit or loss

Cash flow hedge

A cash flow hedge aims to protect the value of a highly probable future cash flow. It usually addresses the fear that the asset may rise in value before it is bought by the business.

- Gains / losses on effective portion of the instrument is recognised in other comprehensive income (OCI)
- Gain or loss on ineffective portion recognised through profit or loss
- Gain or loss on effective portion reclassified through profit or loss when the item is recognised.

Hedge Accounting Criteria

Hedge accounting is permitted under certain circumstances provided that all the following conditions are met:

- Formally designated and documented (including the entity's risk management objective and strategy for undertaking the hedge, identification of the hedging instrument, the hedged item, the nature of the risk being hedged, and how the entity will assess the hedging instrument's effectiveness)
- The hedging relationship consists of eligible hedging instruments and eligible hedged items
- The hedge is effective through an economic relationship between the item and instrument, the effect of credit risk does not dominate the changes in value, designated hedge ratio is consistent with risk management strategy.



Hedge effectiveness

The changes in the value of the item may not match up exactly to the changes in the value of the instrument. This gives rise to an ineffectiveness in the hedge.

- 'Over-hedge' – change in instrument > change in item, and ineffectiveness in the hedge and the gain/loss recognised through other comprehensive income is equivalent to the change in the item (lower)
- 'Under-hedge' – change in instrument < change in item, and no ineffectiveness in the hedge and the gain/loss recognised through other comprehensive income is equivalent to the change in the instrument (lower)

Illustration – Hedge effectiveness (over hedge)

If the gain on the hedging instrument is \$0.5 million and the loss on the hedged item is \$0.4 million then we have an over hedge as the change in instrument > change in item.

The ineffectiveness is accounted for as follows:

- \$0.4 million gain recognised through other comprehensive income, equivalent to the change in the item (lower)
- \$0.1 million ineffective portion of the gain recognised through profit or loss

Illustration – Hedge effectiveness (under hedge)

If the gain on the hedging instrument is \$0.8 million and the loss on the hedged item is \$1.0 million then we have an under hedge as the change in instrument < change in item.

- The \$0.8 million gain recognised through other comprehensive income is equivalent to the change in the instrument (lower)
- No ineffective portion on the instrument as 'under-hedge'

7. Disclosure (IFRS 7)

Financial instruments, particularly derivatives, often require little initial investment, though may result in substantial losses or gains and as such stakeholders need to be informed of their existence. The objective of IFRS7 is to allow users of the accounts to evaluate:

- The significance of the financial instruments for the entity's financial position and performance
- The nature and extent of risks arising from financial instruments
- The management of the risks arising from financial instruments

Nature and extent of financial risks

Financial risk arising from the use of financial instruments can be defined as:

- Credit risk
- Liquidity risk
- Market risk

Disclosures with regards to these risks need to be both **qualitative** and **quantitative**.



Chapter 16

FAIR VALUE (IFRS 13)

IASB has adopted a fair value method to measure assets and liabilities in its IFRS accounting standards because the historic cost convention was not consistent with the underlying qualitative characteristic of relevance.

The issue was that there was no definition of what fair value actually was, until IFRS 13 was created.

Fair value – The price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

The price should not be adjusted for transaction costs, but it is adjusted for transport costs.”

IFRS 13 adopts a hierarchical approach to measuring fair value, whilst giving consideration to the principal market, being the largest market in which an asset/liability is traded. It also considers the highest and best use of an asset and if no principal market exists then we consider the most advantageous market.

Illustration – Markets

Roy is a UK company and sells fruit and vegetables to both retailers and manufacturers, but also sells produce overseas.

The following data relates to the produce that is sold:

	<i>Sales to retailers</i>	<i>Sales to manufacturers</i>	<i>Export sales</i>
Annual sales volume	7,000 tonnes	5,000 tonnes	3,000 tonnes
Price per tonne	\$650	\$500	\$800

The principal market is the sales to retailers market as it has the greatest volume, whilst the export sales market is the most advantageous as it maximises the amount from selling the produce.

Level 1 inputs

Level 1 inputs are quoted prices in active markets (frequency and volume) for identical assets or liabilities that the entity can access at the measurement date.

A quoted market price in an active market provides the most reliable evidence of fair value and is used without adjustment to measure fair value whenever available, with limited exceptions.

Level 2 inputs

Level 2 inputs are inputs other than quoted market prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.

Level 2 inputs include:

- quoted prices for similar assets or liabilities in active markets
- quoted prices for identical or similar assets or liabilities in markets that are not active
- inputs other than quoted prices that are observable for the asset or liability, for example interest rates and yield curves observable at commonly quoted intervals



Level 3 inputs

Level 3 inputs are unobservable inputs for the asset or liability and covers the scenarios whereby there is little, if any, market activity.

An entity develops unobservable inputs using the best information available in the circumstances, which might include the entity's own data, taking into account all information about market participant assumptions that is reasonably available.



Chapter 17

OPERATING SEGMENTS (IFRS 8)

IFRS 8 Operating segments aims to assist users to:

- Understand past performance
- Understand the risk and returns of each segment
- Make better informed judgements

An operating segment is one whose results are regularly reviewed by the **chief operating decision maker** (CODM), thus giving the users of the accounts an internal view of the company and how the results are reviewed.

Disclosure

An operating segments results must be disclosed if:

- Segment revenue is greater than 10% of the total revenue (internal and external)
- Segment profits are greater than 10% of the total profits (excluding losses)
- Segment assets are greater than 10% of total assets

If the total reportable segment revenue does not make up at least 75% of external revenue then additional segment will need to be disclosed.

Two or more operating segments may be combined if they have similar economic characteristics with regards to the following:

- The nature of the products or services
- The nature of the production process
- The type or class of customer
- The methods used to distribute the products/services
- The nature of the regulatory environment

Each reportable segment should then disclose:

- Segment revenue
- Segment results
- Segment assets
- Segment liabilities
- Capital expenditure
- Depreciation/amortisation
- Other non-cash expenses



General disclosures are:

- How the operating segments have been identified
- The products and services that the group provides
- Reliance on major customers
- Geographical information (limited to revenue and non-current assets)

Example 1 – Operating segments

Gulf is preparing its operating segment disclosure note for the first time following its listing on the local stock exchange during the year. Its chief operating decision maker (CODM) regularly reviews the results of its three separate divisions:

- Domestic railway operations
- International railway operations
- Railway construction

Gulf is intending to report two operating segments in its disclosure note as opposed to the three reviewed by the CODM. The domestic and international operations are to be combined because it is felt that they have similar economic characteristics due to the services that they offer.

The domestic operations involve a competitive tender process to run the railway service, which is then awarded by the local transport authority. The local transport authority then sets the ticket prices and collects the fares which are then distributed amongst the various operators running the contracts.

The international operations' ticket prices are set by Gulf, who collects the fares from the passengers directly.

Advise Gulf as to whether the proposed combination of the two operating segments is appropriate.



Chapter 18

REVENUE FROM CONTRACTS WITH CUSTOMERS (IFRS 15)

IFRS 15 has replaced the previous IFRS on revenue recognition, IAS 18 Revenue and IAS 11 Construction Contracts. It uses a principles-based 5-step approach to apply to contract with customers.

The five steps are as follows:

1. Identification of contracts
2. Identification of performance obligations (goods, services or a bundle of goods and services)
3. Determination of transaction price
4. Allocation of the price to performance obligations
5. Recognition of revenue when/as performance obligations are satisfied

1. Identification of contracts

The contract does not have to be a written one, it can be verbal or implied. In order for IFRS 15 to apply the following must all be met:

- The contract is approved by all parties
- The rights and payment terms can be identified
- The contract has commercial substance
- It is probable that revenue will be collected

1.1 Contract combination

Two or more similar contracts with the same customer can be combined if the following apply:

- the contracts are negotiated as a single package with a single commercial objective
- the amount of consideration to be paid in one contract depends on the price or performance of the other contract; or
- the goods or services promised in the contracts (or some goods or services promised in each of the contracts) are a single performance obligation in accordance with paragraphs 22–30.



1.2 Contract modification

If during the contract duration both parties approve a change in the scope, price or both then there is a modification of the contract. The treatment of the modification will either be that of a separate contract or accounting as part of the original contract.

Separate contract

- Additional goods/services distinct
- Consideration reflects the stand-alone selling prices

Note: If the goods and services are distinct but consideration does not reflect the stand-alone prices then we account for it as the termination of the existing contract and creation of a new contract

NOT a separate contract

- Additional goods/services **not** distinct
- Consideration **does not** reflect the stand-alone selling prices.



Account for it as part of the original contract

Illustration – Contract modification (1)

A business sells 120 products at a price of \$100 each. The products are transferred to the customer over a six-month period and the entity transfers control of each product at a point in time.

After 60 products have been transferred it is agreed that an additional 30 identical products will be produced and sold to the customer at a price of \$95 each.

The goods delivered are distinct, as the customer benefits from them on their own and it is separately identifiable. The price also reflects the stand-alone price and so the entity recognises the revenue from the first 120 products at \$100 each and the final 30 products at \$95 each, as it is a separate contract.

Illustration – Contract modification (2)

A business sells 120 products at a price of \$100 each. The products are transferred to the customer over a six-month period and the entity transfers control of each product at a point in time.

After 60 products have been transferred it is agreed that an additional 30 identical products will be produced and sold to the customer at a price of \$80 each. The original 60 products sold contained defects and so a discount of \$15 per product was agreed as compensation, which will be credited against the selling price of the additional units.

The goods delivered are distinct but the consideration does not reflect the stand-alone price therefore the old contract is terminated after the sale of 60 units and then a new contract created for the sale of the final 90 products. The issue is at what price the products are recognised at in the new contract.

New selling price = $(\$100 \times 60 \text{ original products to be sold}) + (\$80 \times 30 \text{ additional units to be sold}) / 90 \text{ products to be sold}$

New selling price = \$93.33 per product

Note: The revenue for the original 60 products sold will be reduced by the amount of the \$15 credit note per product.



2. Identification of performance obligations

If the goods or services that have agreed to be exchanged under the contract are distinct (i.e. could be sold alone) then they should be accounted for separately.

If a series of goods or services are substantially the same they are treated as a single performance obligation.

Illustration – Performance obligations

LiverTech is a computer business that primarily sells computer hardware. As well as selling computers, it also supplies and installs the software to its customers and provides a technical support package over a number of years. The business commonly sells the supply and installation, and technical support in a combined goods and services contract.

The combined goods and services contract has two separate performance obligations, which would need to be separated out and recognised separately.

The installation of software would be recognised once complete and the provision of technical services over the period of the support service.

3. Determination of transaction price

The amount the selling party expects to receive is the transaction price.

This should consider the following:

- Significant financing components
- Variable consideration
- Refunds and rebates (paid to the customer!)

Example 1 – Transaction price

Luckers Co. sells a car to a customer for \$10,000, offering interest-free credit for a three-year period. The car is delivered to the customer immediately. The annual market rate of interest on the provision of consumer credit to similar customers is 5%.

What is the transaction price?

4. Allocation of the price

The price is allocated proportionately to the separate performance obligations based upon the stand-alone selling price.

Example 2 – Allocation of price

Richer Co. sells home entertainment systems including a two-year repair and maintenance package for \$10,000. The price of a home entertainment system without the repair and maintenance contract is \$9,000 and the price to renew a two-year maintenance package is \$2,000.

How is the \$10,000 contract price allocated to the separate performance obligations?

Note: Ignore any discounting and time value of money.



5. Recognition of revenue

Once control of goods or services transfers to the customer, the performance obligation is satisfied and revenue is recognised. This may occur at a single point in time, or over a period of time.

If a performance obligation is satisfied at a single point in time, we should consider the following in assessing the transfer of control:

- Present right to payment for the asset
- Transferred legal title to the asset
- Transferred physical possession of the asset
- Transferred the risks and rewards of ownership to the customer
- Customer has accepted the asset.

Example 3 – IFRS 15 (1)

Telephonica sells mobile phones, selling them for “free” when a customer signs up for a 12 month contract. The contract costs the customer \$45 per month.

Explain how the revenue should be recognised in Telephonica’s financial statements

Note: Vodaphone sells mobile phones without a monthly contract, selling the handset for \$480. Call and data charges are \$20 per month. Ignore discounting and the time value of money

Example 4 – IFRS 15 (2)

LiverTech is a computer business that primarily sells computer hardware. As well as selling computers, it also supplies and installs the software to its customers and provides a technical support package over two years. The business commonly sells the supply and installation, and technical support in a combined goods and services contract.

The combined goods and services contract sells for \$1,600, but if sold separately the supply and installation is sold for \$1,500 and the technical support for \$500.

If LiverTech sold a combined contract on 1 July 20X7, demonstrate how the transaction would be presented in the financial statements for the year ended 31 December 20X7.

If a performance obligation is transferred over time, the completion of the performance obligation is measured using either of the following methods:

- Output method – revenue is recognised based upon the value to the customer, i.e. work certified.

$$\text{Output method} = \frac{\text{Work certified to date}}{\text{Total contract revenue}}$$

- Input method – revenue is recognised based upon the amounts the entity has used, i.e. costs incurred or labour hours.

$$\text{Input method (cost based)} = \frac{\text{Costs to date}}{\text{Total estimated costs}}$$



Example 5 – Performance obligations over time and the statement of profit or loss (1)

Alex commenced a three year building contract during the year-ended 31 December 20X4 and continued the contract during 20X5. The details of the contract are as follows:

	\$m
Total contract value	45
Costs incurred to date @ 20X5	20
Estimated costs to completion	12
Work certified as completed in 20X5	15
Stage of completion @ 20X5	70%
Profit recognised to date @ 20X4	3.3

Show how this contract would be dealt with in the statement of profit or loss for the year ended 31 December 20X5.

Where not profit can be calculated if contracts spanning more than one accounting period, i.e. it is loss making, then the revenue is limited to the recoverable costs.

Example 6 – Performance obligations over time and the statement of profit or loss (2)

Evelyn commenced a building contract in 20X5 that has seen large increases in future costs to complete. The contract will still be completed on schedule in 20X6. The details from the year ended 31 December 20X5 are as follows:

	\$m
Total contract value	40
Costs incurred to date	25
Estimated costs to completion	20
Stage of completion	45%

Show how this contract would be accounted for in the statement of profit or loss for the year ended 31 December 20X5.

As contracts that span more than one accounting period progress, the company is creating an asset for the customer that needs to be recognised in the statement of financial position. The amount to be recognised is as follows:

	\$
Costs incurred to date	X
Recognised profits	X
Recognised losses	(X)
Receivables (amounts invoiced)	(X)
Contract asset/(liability)	X/(X)



Example 7 – Performance obligations over time and the statement of financial position

Noah has a three year contract which commenced on 1 January 20X5. At 31 December 20X5 Noah extracted the following balances from its ledger relating to the contract:

	\$000	\$000
Total contract value		140,000
Cost incurred up to 31 December 20X5:		
Attributable to work completed	52,000	
Inventory purchased for use in future years	<u>8,000</u>	60,000
Progress billing to date		45,000
Cash received		26,500
Other information:		
Expected further costs to completion		48,000

At 31 December 20X5, the contract was certified as 40% complete.

Prepare extracts from the statement of profit or loss and statement of financial position for the year-ended 31 December 20X5.

6. Specifics

Principal vs agent - When a third party is involved in providing goods or services to a customer, the seller is required to determine whether the nature of its promise is a performance obligation to:

- Provide the specified goods or services itself (principal) or
- Arrange for a third party to provide those goods or services (agent)

Repurchase agreements - When a vendor sells an asset to a customer and is either required, or has an option, to repurchase the asset. The legal form here is always a sale followed by a purchase at a later date. The economic substance is more likely to be a loan secured against an asset that is never actually being sold.

Bill and hold arrangements - an entity bills a customer for a product but the entity retains physical possession of the product until it is transferred to the customer at a point in time in the future

Consignments – arises where a vendor delivers a product to another party, such as a dealer or retailer, for sale to end customers. The inventory is recognised in the books of the entity that bears the significant risk and reward of ownership (e.g. risk of damage, obsolescence, lack of demand for vehicles, no opportunity to return them, the showroom-owner must buy within a specified time if not sold to public)



Chapter 19

LEASES (IFRS 16)

IFRS 16 Leases is to be adopted for accounting periods starting on or after 1 January 2019. It can be adopted earlier but only if the entity has already adopted IFRS 15 Revenue from contracts with customers.

The new standard on leases is replacing the old standard (IAS 17) where the existence of operating leases meant that significant amounts of finance were held off the balance sheet. In adopting the new standard all leases will now be brought on to the statement of financial position, except in the following circumstances:

- leases with a lease term of 12 months or less and containing no purchase options – this election is made by class of underlying asset; and
- leases where the underlying asset has a low value when new (such as personal computers or small items of office furniture) – this election can be made on a lease-by-lease basis.

The accounting for low value or short-term leases is done through expensing the rental through profit or loss on a straight-line basis.

Example 1 – Low-value assets

Banana leases out a machine to Mango under a four year operating lease and Mango elects to apply the low-value exemption.

The terms of the lease are that the annual lease rentals are \$2,000 payable in arrears. As an incentive, Banana grants Mango a rent-free period in the first year.

Explain how Mango would account for the lease in the financial statements.

1. Identifying a lease

A contract is, or contains, a lease if it conveys the right to control the use of an identified asset for a period of time in exchange for consideration [IFRS16:9]

Control is conveyed where the customer has both the right to direct the identified asset's use and to obtain substantially all the economic benefits from that use. [IFRS 16:B9] However, if the supplier has a substantive right to substitute the asset during the period of use then the customer does not have the right of use of the asset and hence there is no lease.

Example 2 – Identifying a lease

For each of the two following scenarios explain if the contract is a lease or if it contains a lease.

1. Peach needs to transport its goods to customers in Europe using rail freight. The company enters into a contract with a rail freight carrier for the use of 10 rail cars of a particular type for five years.
2. Peach needs to transport its goods to customers in Europe using rail freight. The company enters into a contract with a rail freight carrier that requires the carrier to transport a specified quantity of goods by using a specified type of rail car in accordance with a stated timetable for five years



2. Lease and non-lease components

A combined contract where part of the payment is for the lease of the asset and part of the payment is for the provision of additional services by the lessor (e.g. maintenance) then the lessee needs to split the rental into a lease component and non-lease component. The payment by the lessee is to be allocated based on the stand-alone prices of the components.

Example 3 – Lease and non-lease components

Pear enters into a contract for the use of an item of machinery and its annual maintenance for a combined total of \$100,000 per annum, payable at the end of the lease period.

The rental of the machinery without any maintenance is \$95,000 per annum, whilst a stand-alone maintenance contract is \$10,000 per annum.

Explain how the annual rental should be split between the lease and non-lease component.

3. Lessee accounting

Initial recognition

At the start of the lease the lessee initially recognises a right-of-use asset and a lease liability. [IFRS 16:22]

Right of use asset

Measured at the amount of the lease liability plus any initial direct costs incurred by the lessee.

- Lease liability
- Initial direct costs
- Estimated costs for dismantling
- Payments less incentives before commencement date

Lease liability

Measured at the present value of the lease payments payable over the lease term, discounted at the rate implicit in the lease

- Fixed payments less incentives
- Variable payments (e.g. CPI/rate)
- Expected residual value guarantee
- Penalty for terminating (if reasonably certain)
- Exercise price of purchase option (if reasonably certain)

Note: if the rate implicit in the lease cannot be determined the lessee shall use their incremental borrowing rate

Subsequent measurement

Right of use asset

Cost less accumulated depreciation

Note: Depreciation is based on the earlier of the useful life and lease term, unless ownership transfers, in which case use the useful life.

Lease liability

Financial liability at amortised cost



Example 4 – Lessee accounting

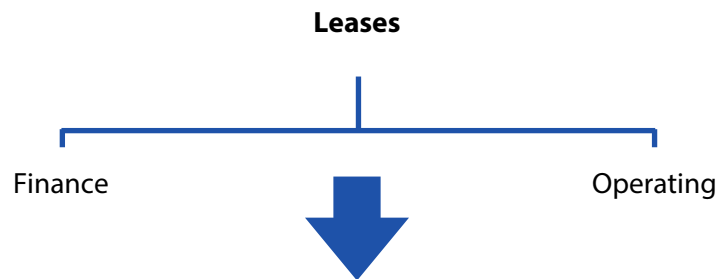
On 1 January 2015, Plum entered into a five year finance lease of machinery. The machinery has a useful life of six years. The annual lease payments are \$5,000 per annum, with the first payment made on 1 January 2015. To obtain the lease Plum incurs initial direct costs of \$1,000 in relation to the arrangement of the lease but the lessor agrees to reimburse Plum \$500 towards the costs of the lease.

The rate implicit in the lease is 5%. The present value of the minimum lease payments is \$22,730.

Demonstrate how the lease will be accounted in the financial statements over the five year period.

4. Lessor accounting

Classification of the lease



Finance lease if risks and rewards of ownership transferred to lessee.

- Ownership passes at end of the lease term
- Option to purchase asset at below fair value at end of lease and reasonably certain option will be exercised
- Lease term represents the major part of assets economic life
- PV of minimum lease payments represents substantially all of the asset's fair value
- Leased asset is specialised in nature

Operating lease accounting

Operating lease income receipts are recognised as income through profit or loss on a straight line basis.

Depreciation on the asset continues over its useful life.

Example 5 – Operating leases

Banana leases out a machine to Mango under a four year operating lease. The terms of the lease are that the annual lease rentals are \$2,000 payable in arrears. As an incentive, Banana grants Mango a rent free period in the first year.

Explain how both Banana would account for the lease in the financial statements.

Finance lease accounting

1. Derecognise asset and record a receivable (@ net investment in the lease")
2. Record finance lease receipts as a reduction in the receivable
3. Record interest income on the receivable

Net investment in the lease = Gross investment in the lease discounted at the implicit rate of interest

Gross investment in the lease = Minimum lease payments receivable plus any unguaranteed residual value

Example 6 – Finance lease

Cherry leases out an item of property, plant and equipment under a 5 year finance lease. The lease commenced on 1 January 2015 and the rate implicit in the lease is 4%. The annual lease rentals of \$5,000 are paid at the start of the lease period.

Cherry estimates that the estimated residual value of the item of property, plant and equipment is \$2,000 and the guaranteed residual value is \$1,600.

Calculate Cherry's net investment in the lease, showing the guaranteed and the unguaranteed amounts.



5. Sale and leaseback

A sale and leaseback transaction occurs when one entity (seller) transfers an asset to another entity (buyer) who then leases the asset back to the original seller (lessee).

The companies are required to account for the transfer contract and the lease applying IFRS 16, however consideration is first given to whether the initial sale of the transferred asset is a performance obligation under IFRS 15.

If the transfer of the asset is not a sale then the following rules apply:

Seller-Lessee

- Continue to recognise the asset
- Recognise a financial liability (= proceeds)

Buyer-Lessor

- Do not recognise the asset
- Recognise a financial asset (= proceeds)

If the transfer of the asset is a sale then the following rules apply:

Seller-Lessee

- Derecognise the asset
- Recognise the sale at fair value
- Recognise lease liability (PV of lease rentals)
- Recognise a right-of-use asset, as a proportion of the previous carrying value of underlying asset
- Gain/loss on rights transferred to the buyer

Buyer-Lessor

- Recognise purchase of the asset
- Apply lessor accounting

Example 7 – Sale and leaseback (1)

Apple required funds to finance a new ambitious rebranding exercise. It's only possible way of raising finance is through the sale and leaseback of its head office building for a period of 10 years. The lease payments of \$1 million are to be made at the end of the lease period

The current fair value of the building is \$10 million and the carrying value is \$8.4 million. The interest rate implicit in the lease is 5%.

Advise Apple on how to account for the sale and leaseback in its financial statements if the office building were to be sold at the fair value of \$10 million and:

- Performance obligations are not satisfied; or,
- Performance obligations are satisfied.

Note: If the proceeds are less than the fair value of the asset or the lease payments are less than market rental the following adjustments to sales proceeds apply:

- Any below-market terms should be accounted for as a prepayment of the lease payments; and,
- Any above-market terms should be accounted for as additional financing provided to the lessee.



Example 8 – Sale and leaseback (2)

Apple required funds to finance a new ambitious rebranding exercise. It's only possible way of raising finance is through the sale and leaseback of its head office building for a period of 10 years. The lease payments of \$1 million are to be made at the end of the lease period

The current fair value of the building is \$10 million and the carrying value is \$8.4 million. The interest rate implicit in the lease is 5%.

Advise Apple on how to account for the sale and leaseback in its financial statements if the performance obligations are satisfied and the building is sold for the following:

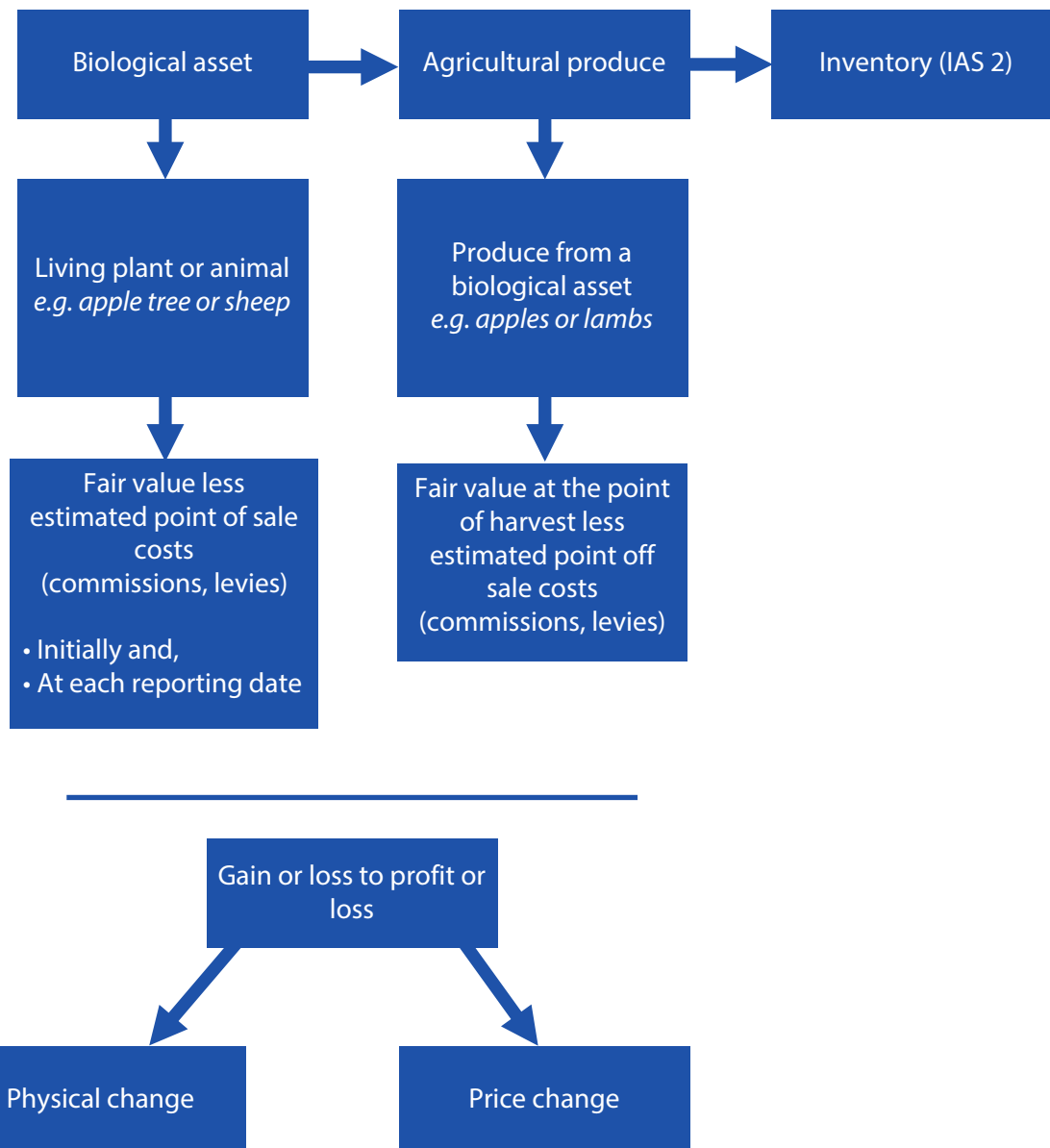
- i) \$9 million; or,
- ii) \$11 million.



Chapter 20

INVENTORY AND AGRICULTURE

1. Agriculture (IAS 41)



Note:

- Agricultural land is accounted for under IAS 16 Property, plant and equipment
- Milk quotas are accounted for under IAS 38 Intangible assets
- Grant income for agricultural activity is credited to profit or loss as soon as they are unconditionally receivable.



Example 1 – Agriculture

Ted started running a farm that is involved in agricultural activity whereby it buys dairy producing cows.

At the start of the financial year Ted purchased 1,000 dairy cows, with an average age of 2 years old, for \$1.50 million.

Ted has the following data on fair values of agricultural activity:

	<i>Fair value less point of sale costs</i>	
	<i>Start of year</i>	<i>End of year</i>
	\$	\$
Two year old cows (per cow)	1,500.00	1,550.25
Three year old cows (per cow)	1,590.80	1,650.10

Explain the accounting treatment of the above in the financial statements.



2. Inventory (IAS 2)

Measure @ lower of

Cost	NRV
Costs incurred in bringing inventory to its present condition and location	Selling price X
<ul style="list-style-type: none"> Materials Labour Manufacturing overheads (based on normal output) 	Less: Costs to complete (X) Costs of selling (X) NRV X

Note:

Inventory is valued on a line by line basis

Example 2 – Inventory

Bravo manufactures components for the retail industry. The inventory is currently valued at cost.

The cost structure of the equipment is as follows:

	<i>Cost per unit</i>	<i>Selling price per unit</i>
	\$	\$
Production process – 1 st stage	1,000	1,050
Conversion costs – 2 nd stage	500	
Finished product	1,500	1,700

The selling costs are \$10 per unit and Bravo has 100,000 units at the first stage of production and 200,000 units of finished product.

Shortly after the year-end a competitor released a new model and this has resulted in Bravo having to reduce its selling price to \$1,450 for the finished product and \$950 for the first stage of production.

Calculate the value of closing inventory to be included in Bravo's financial statements at the reporting date.





Chapter 21

DEFERRED TAX (IAS 12)

Deferred tax arises on temporary differences between the carrying value of an asset or liability and its tax base.

1. Calculating deferred tax

1. Calculate the temporary difference, as being the difference between the carrying value of the asset or liability and its tax base.

	<i>\$'000s</i>
Carrying value	X
Tax base	X
Temporary difference	X

2. Calculate the deferred tax position by multiplying the temporary difference by the income tax rate at which the asset or liability will be settled at.
 $X\% \times \text{temporary difference} = \text{closing deferred tax provision}$

3. The closing deferred tax position is either a deferred tax asset or a liability.

A deferred tax liability arises if:

Carrying value > Tax base – taxable temporary difference

A deferred tax asset arises if:

Carrying value < Tax base – tax deductible temporary difference

4. The movement in the deferred tax position goes through profit or loss.

	<i>\$'000s</i>
Closing position	X
Opening position	X
Movement	X/(X)

Increase in deferred tax

Dr Income tax expense (SPL)

Cr Deferred tax provision

Decrease in deferred tax

Dr Deferred tax

Cr Income tax expense (SPL)



2. Individual company accounts

1.	Property, plant and equipment				
	Carrying value		vs.	Tax base	
	(IAS 16)				
	X			X	
2.	Provisions				
	Carrying value		vs.	Tax base	
	(IAS 37)				
	(X)			Nil	
3.	Intangibles (development costs)				
	Carrying value		vs.	Tax base	
	(IAS 38)				
	X			Nil	
4.	Share based payments				
	Carrying value		vs.	Tax base	
	(IFRS-2)				
	(X)			Nil	

Tax written down value (arrow points to X in row 1, column 5)
 Intrinsic value (arrow points to (X) in row 4, column 1)

Example 1 – Accelerated capital allowances

Osborne buys an asset for \$150,000 at the start of the financial year. The asset has an estimated life of 6 years and an estimated residual value of \$30,000.

Capital allowances are available at a rate of 25% reducing balance and the tax rate is 20%.

Calculate the deferred tax asset/liability to appear in the statement of financial position for the next three years and the debit/credit charged to the tax expense in the statement of profit or loss for the same period.

Example 2 – Share based payments

Brown has granted 1,000 equity settled share based payment scheme to each of its 100 employees. The vesting period is four years and no employees are expected to leave over this period.

The fair value of the option at the grant date was \$2 and its intrinsic value at the end of the first year was \$1.60.

Calculate the deferred tax balance to appear in the statement of financial position at the end of the first year in relation to the share based payment scheme.



Example 3 – Revaluations

Clarke bought a property for \$500,000 on 1 January 2015.

On 31 December 2015 the property had a carrying value of \$480,000 and was revalued to \$800,000. The tax written down value at 31 December 2015 was \$420,000 and the tax rate is 20%.

Explain how the revaluation, including any deferred tax impact, should be dealt with in Clarke's financial statements for the year-ended 31 December 2015.

3. Losses

If an entity has unused tax losses to carry forward, a deferred tax asset should be recognised to the extent that it is possible that future taxable profits will be available against which the losses will be offset.

4. Group accounts

- Fair value adjustments

The assets and liabilities of the subsidiary are consolidated at fair value, which will give rise to temporary differences as the tax will have been calculated by the tax authorities using their original costs.

The fair values of the consolidated assets and liabilities are usually higher than their book value so the temporary difference will give rise to an additional deferred tax liability (carrying value > tax base).

The deferred tax liability is recorded in the group statement of financial position and the opposing entry taken to consolidated goodwill.

- Goodwill

The calculation of goodwill in the consolidated financial statements does not give rise to a temporary difference as the tax authorities will never recognise goodwill. It is therefore considered to be a **permanent difference** and no deferred tax arises.

- PUP adjustments

Profit made on sale between group companies whereby the inventory is still in the group at year end are eliminated as a PUP adjustment. Accordingly therefore any tax on the profit made will need to be eliminated which will give rise to a deferred tax asset.

On subsequent sale of the goods outside of the group in subsequent years the deferred tax asset can be released.





Chapter 22

FIRST TIME ADOPTION (IFRS 1)

IFRS 1 *First-time Adoption of International Financial Reporting Standards* sets out the procedures that an entity must follow when it adopts IFRSs for the first time.

An entity adopting IFRS for the first time must explicitly state that it is adopting IFRS for the first time and consider the following:

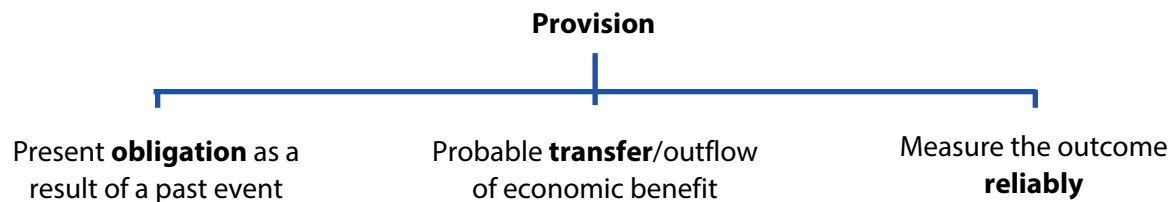
- Prepare the current year financial statement under IFRS
- Restate the prior year comparatives under IFRS
- Reconcile the current year profit under IFRS to the profit that would have been reported under local GAAP.





Chapter 23

PROVISIONS, CONTINGENT ASSETS AND LIABILITIES (IAS 37)

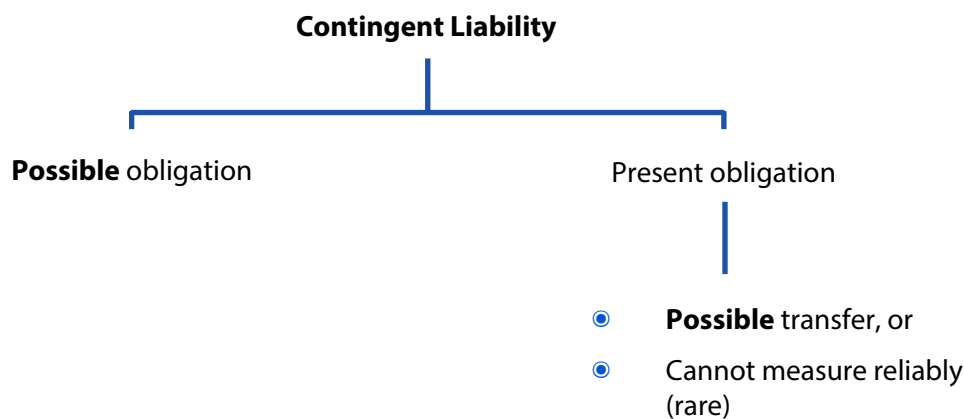


1. Measurement

- Best estimate of expenditure
- Expected values (various different outcomes)
- Discount to present value if materially different

2. Subsequent treatment

- Review the provision annually
- Only use the provision for expense originally created



Example 1 – Provisions and contingent liabilities

York operates in the oil industry and is regularly involved in the contamination of land, seas and rivers given the nature of the business. It does however have a publicised environmental policy on its website and in its annual report that states that it will clean up any environmental damage incurred.

It is currently involved in three major projects where the costs of cleaning up the contamination and the local laws regarding environmental clean-up are given.

Environmental clean-up costs

\$4 million
\$5 million
\$6 million

Local laws

Law enforces the clean-up of environmental damage
No law exists for the clean-up of environmental damage
Law to enforce clean -p of environmental damage will come into force in the next accounting period

Explain how York should account for the above environmental clean-up costs in its financial statements.

3. Specifics

Future operating losses

No provision can be made for anticipated losses as there is no obligation.

Onerous contracts

An onerous contract is whereby the cost of fulfilling the contract exceed the benefits received from the contract (e.g. non-cancellable operating lease).

A provision is recognised at the lower of:

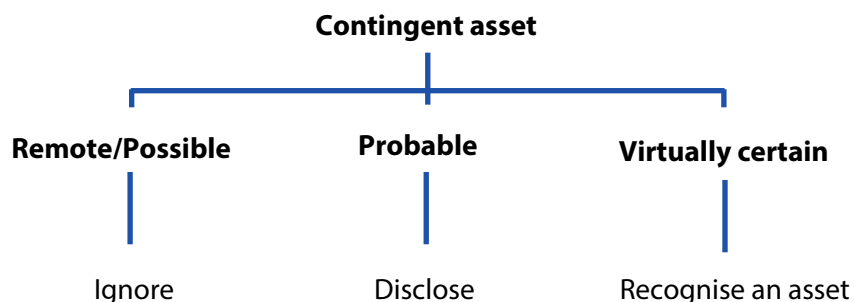
- Present value of continuing under the contract, and
- Present value of exiting the contract

Restructuring

- Sale or closure of a line of business
- Ceasing activities in a geographical location
- Relocating activities
- Re-organisation (management or focus of operations)

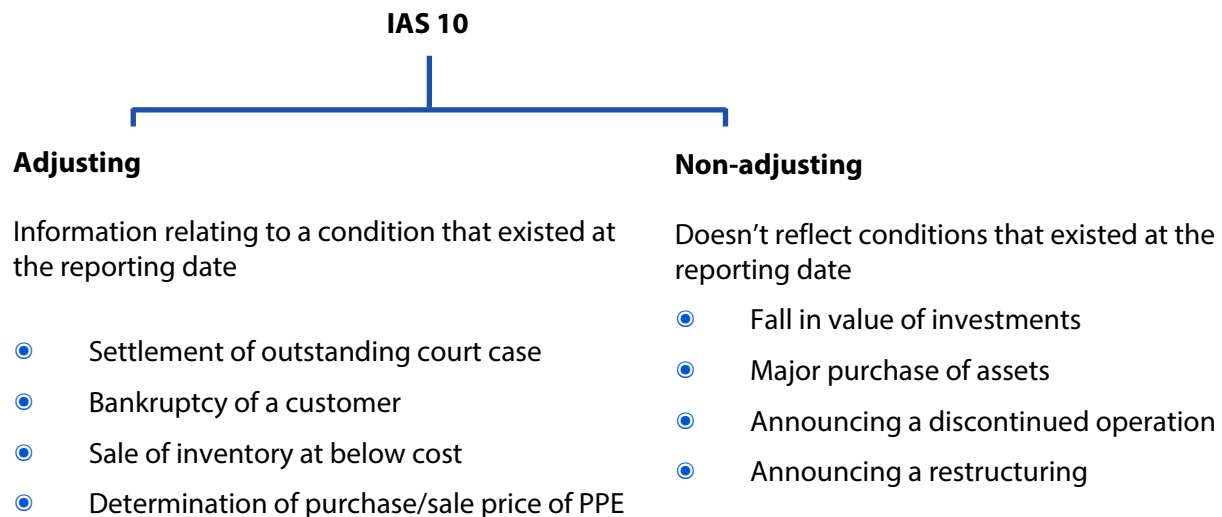
A provision is recognised if there is a detailed formal plan and the plan has been announced.

The provision only includes costs which are necessarily to be incurred and not associated with continuing activities.



Chapter 24

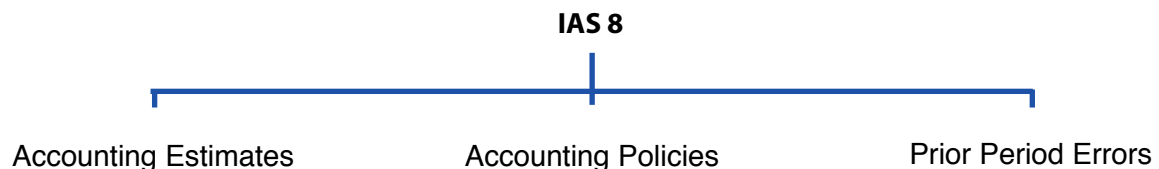
EVENTS AFTER THE REPORTING DATE (IAS 10)





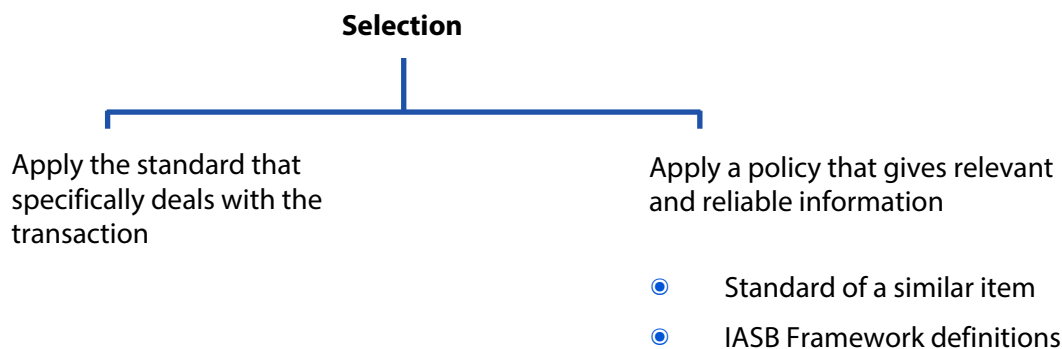
Chapter 25

ACCOUNTING POLICIES, CHANGES IN ACCOUNTING ESTIMATE AND ERRORS (IAS 8)

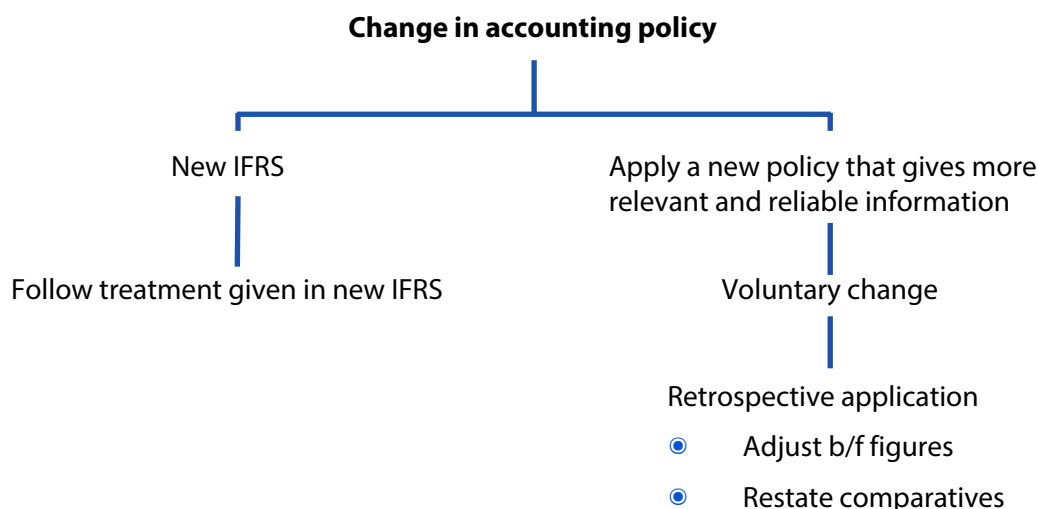


1. Accounting policies

The specific principles, bases, conventions, rules and practices applied by an entity in preparing and presenting the financial statements.



1



2. Accounting estimates

Changes in accounting estimate are recognised prospectively:

- Period of change
- Period of change and future periods

Example 1 – Accounting Estimates

If a company decides to change its method of depreciation from straight line method to reducing balance method.

If a company decides to change from capitalising finance costs to immediate write off.

Would the following be a change in accounting policy or revision of an estimate?

3. Prior period error

Accounting errors (omissions and misstatements) include:

- Errors in applying accounting policies
- Oversights
- Fraud and the effects of fraud

Material errors are corrected retrospectively, the same as for a change in accounting policy.



Chapter 26

RELATED PARTIES (IAS 24)

1. Related party

A party is related to an entity if it either:

- controls, is controlled by, or is under common control with, the entity
- has an interest in the entity that gives a significant influence over the entity
- has joint control over the entity
- is an associate (IAS 28 Investment in Associates)
- is a joint venture in which the entity is a venturer (IAS 31 Interests in joint ventures)
- is a member of the key management personnel of the entity or its parent
- is a close family member of any of the above
- is a post-employment benefit plan for the employees of the entity or of any entity that is a related party of the entity

2. Related party transactions

- Purchase or sale of goods/components
- Purchase or sale of asset/property
- Provision and receipt of services
- Leasing (operating/finance)
- Research and development transfers
- Settlement of another party's liabilities

3. Key management personnel

Those persons having authority and responsibility for planning, directing and controlling the activities of the entity, directly or indirectly, including any director of that entity.

4. Related party disclosures

Relationships between parents and subsidiaries shall be disclosed irrespective of whether there have been transactions between those related parties.

- Name of entity's parent and;
- If different the ultimate controlling party



5. Disclosure of transactions and balances generally

If there have been transactions between related parties, an entity should disclose the nature of the related party relationships as well as information about the types of transactions and the outstanding balances necessary for an understanding of the financial statements.

Disclosure should be made irrespective of whether a price is charged.

At a minimum the disclosure should include:

- The amount of the transactions
- The amount of outstanding balances, including terms and conditions, whether they are secured and the nature of the consideration to be provided
- Provisions for doubtful debts based on the amount outstanding
- The expense recognised during the period in relation to bad and doubtful debts

The above should be made separately for each of the following

- The parent
- Entities with joint control or significant influence over the entity
- Subsidiaries
- Associates
- Joint ventures in which the entity is a venture
- Key management personnel
- Other related parties

6. Disclosure of key management personnel compensation

Key management personnel compensation in total and for each of the following;

- Short-term employee benefits
- Post-employment benefits
- Other long term benefits
- Share based payments

Note: Providers of finance, trade unions, utility providers, government departments, customers and suppliers are NOT related parties.



Chapter 27

EARNINGS PER SHARE (IAS 33)

1. Basic Earnings per Share

$$\text{Basic Earnings per Share} = \frac{\text{Profit attributable to ordinary shareholders of the parent}}{\text{Weighted average number of shares}}$$

If the number of shares has changed during the period the following assumptions are made regarding the weighted average number of shares:

- **Full price issue** Normal weighted average calculation
- **Bonus issues** Assume that the bonus shares have always been in issue (and therefore alter the comparative EPS amount)
- **Rights issue** Assume that the shares issued are a mix of bonus and full price shares. For the bonus element assume that they have always been in issue and therefore adjust the comparative

If bonus issues or rights issues occur after the reporting date, but before the date of approval of the accounts the EPS should be calculated based on the number of shares following the issue.

2. Diluted earnings per share

This is calculated where potential ordinary shares have been outstanding during the period which would cause EPS to fall if exercised (dilutive instruments).

The earnings should be adjusted by adding back any costs that will not be incurred once the dilutive instruments have been exercised. This will include for post-tax interest saved on convertible debt.

The number of shares will be adjusted to take account of the exercise of the dilutive instrument. This means that adjustment is made:

- **For convertible instruments** By adding the maximum number of shares to be issued in the future
- **For options** By adding the number of effectively "free" shares to be issued when the options are exercised





Chapter 28

INTERIM FINANCIAL REPORTING (IAS 34)

IAS 34 requires only condensed financial statements (headings and sub-totals) and selected explanatory note disclosures, with particular focus on new events, activities and circumstances.

The minimum content specified is as follows:

- Statement of financial position at interim date and previous reporting date.
- Statement of profit or loss and other comprehensive income for both interim/cumulatively to date for the year and previous interim/cumulatively to date for previous year (incl. EPS and diluted EPS)
- Statement of changes in equity cumulatively to interim date and direct comparative
- Statement of cash flows cumulatively to date and comparable period.





Chapter 29

SMALL AND MEDIUM SIZED ENTITIES

Small and medium sized entities are entities that do not have public accountability. This can be either unlisted entities or a non-financial institution.

IFRSs for Small and Medium-sized entities

The *IFRS for SMEs* is a self-contained Standard (less than 250 pages), designed to meet the needs and capabilities of small and medium-sized entities (SMEs), which are estimated to account for over 95 per cent of all companies around the world.

Compared with full IFRS (and many national GAAPs), the *IFRS for SMEs* is less complex in a number of ways:

- Topics not relevant for SMEs are omitted; for example earnings per share, interim financial reporting and segment reporting.
- Many principles for recognising and measuring assets, liabilities, income and expenses in full IFRS are simplified. For example, amortise goodwill; recognise all borrowing and development costs as expenses; cost model for associates and jointly-controlled entities; and undue cost or effort exemptions for specific requirements.
- Significantly fewer disclosures are required (roughly a 90 per cent reduction).
- The Standard has been written in clear, easily translatable language.
- To further reduce the burden for SMEs, revisions are expected to be limited to once every three years.

The IASB completed a comprehensive review of the IFRS for SMEs in 2015 and a useful snapshot of the requirements can be found in the following link

<https://www.grantthornton.co.za/globalassets/ifrs-for-smes-2015-special-edition.pdf>





Chapter 30

INTEGRATED REPORTING <IR>

The International Integrated Reporting Council has issued a Framework that gives the principles and concepts that govern the content of an integrated report. It aims to communicate how an entity will create value over time and identify the key drivers of its value. To do this requires relevant financial and non-financial information.

1. Fundamental Concepts

'An integrated report aims to provide insight about the resources and relationships used and affected by an organisation – these are collectively referred to as "the capitals"

The capitals are stocks of value that are increased, decreased or transformed through the activities and outputs of the organisation. They are categorised in this Framework as:

- Financial
- Manufactured
- Intellectual
- Human
- Natural
- Social and relationship

2. Guiding Principles

A key factor in the development of the framework is that previous attempts to highlight non-financial factors, notably the management commentary and the Operating and Financial Review (OFR), became too cluttered and focussed on the positives and not the negatives. The <IR> framework has therefore recommended Guiding Principles to aid the content of the report and how it is presented.

The Guiding Principles that underpin the preparation and presentation of an integrated report are:

- Strategic focus and orientation
- Connectivity and information
- Stakeholder relationships
- Materiality
- Conciseness
- Reliability and completeness
- Consistency and comparability



3. Content Elements

The key components of an integrated report are as follows:

- Organisational overview and the external environment under which it operates.
- Governance structure and how this supports its ability to create value.
- Business model.
- Risks and opportunities and how they are dealing with them and how they affect the company's ability to create value.
- Strategy and resource allocation.
- Performance and achievement of strategic objectives for the period and outcomes.
- Outlook and challenges facing the company and their implications.
- Basis of preparation and presentation

Exam tip:

The topic of Integrated Reporting was examined in the June 2015 exam.



ETHICS AND CURRENT DEVELOPMENTS

Chapter 31

ETHICS

Directors are responsible for the preparation of the financial statements. The financial statements are to be prepared following IFRS and must show a true and fair view of the entity, however directors may try to manipulate information to:

- Increase their pay/bonuses
- Deliver specific targets e.g. EPS
- Reduce risk of insolvency e.g. through avoiding breach of loan covenants
- Avoiding regulatory interference
- Improve the appearance of part or all of the business prior to an IPO/disposal
- Understate revenue and overstate expenses to reduce tax liabilities

If the financial statements have not been prepared in accordance with IFRS then this may bring about ethical issues as the directors may not have been acting in a professional manner in accordance with their fiduciary duties.

The way in which directors can do this is as follows:

- Window dress the year-end financial statements
- Exercise judgement in applying accounting standards
- Inappropriate recording of transactions

Ethical issues commonly arise where there is a choice of accounting treatments that could be used in preparation of the financial statements. This could involve deliberate overstatement of assets, understatement of liabilities which may then impact on the performance or profitability.

Areas where ethical issues could arise are:

- | | |
|--------------------|------------------------------------|
| • Leases | Classification as short-term lease |
| • Financial assets | Impairment |
| • PPE | Capex. vs. Revex. |
| • Intangibles | Research and development |
| • Goodwill | Fair value vs. Proportionate share |

Exam tip:

Practice all the past exam questions covering ethics





Chapter 32

MANAGEMENT COMMENTARY

In December 2010 The International Accounting Standards Board (IASB) published an International Financial Reporting Standard (IFRS) Practice Statement *Management Commentary*, a broad, non-binding framework for the presentation of narrative reporting to accompany financial statements prepared in accordance with IFRSs.

Management commentary fulfils an important role by providing users of financial statements with a historical and prospective commentary on the entity's financial position, financial performance and cash flows. It serves as a basis for understanding the management's objectives and strategies for achieving those objectives.

The Practice Statement permits entities to adapt the information provided to particular circumstances of their business, including the legal and economic circumstances of individual jurisdictions. This flexible approach will generate more meaningful disclosure about the most important resources, risks and relationships that can affect an entity's value, and how they are managed.

The Practice Statement is not an IFRS. Consequently, an entity need not comply with the Practice Statement to comply with IFRSs.

The Practice Statement suggests the commentary should include narrative and numerate information about:

- Nature of the business
- Management's objectives
- Strategies for achieving the objectives
- Entity's most significant resources, risks and regulations
- Results of operations and prospects
- Critical performance measures and indicators (financial/non-financial)





Chapter 33

CURRENT ISSUES

The current issues within corporate reporting will be examined in either of Section A or B of the exam, and will not be a full question like has been seen in the past. The likelihood is that it will form a part of a question.

To do well and ensure that you can pass the question you need to be able to think about the following:

1. Why do we develop new standards?
2. What is the development process?
3. Understand the current accounting standard and its application.
4. Understand the potential new rules/disclosure in the exposure draft/new IFRS and their application.

The ACCA CPD articles are highly useful to understand current issues in the world of corporate reporting (<http://www.accaglobal.com/uk/en/member/cpd-landing/cpd-online.html>) as well as the technical articles in the SBR section of the ACCA website (<http://www.accaglobal.com/uk/en/student/exam-support-resources/professional-exams-study-resources/strategic-business-reporting/technical-articles.html>).

The world of current issues is forever evolving as new standards are developed, in order to keep up to date with the current proposals of the IASB then their work plan set out the projects currently under development (<https://www.ifrs.org/projects/work-plan/>).





ACCA PAPER SBR

UK VS IFRS DIFFERENCES

1. UK Syllabus

The SBR syllabus for the UK variant paper replaces section C.10 *Reporting requirements of small and medium-sized entities (SMEs)* in the international variant with the following:

- (a) Discuss the financial reporting requirements for UK and Republic of Ireland entities (UK GAAP) and their interaction with the Companies Act requirements.
- (b) Discuss the reasons why an entity might choose to adopt UK GAAP.
- (c) Discuss the scope and basis of preparation of financial statements under UK GAAP.
- (d) Discuss the concepts and pervasive principles set out by UK GAAP
- (e) Discuss and apply the principal differences between UK GAAP and IFRS.

2. Background

UK GAAP previously consisted of FRSs and SSAPs, which were the equivalent to IFRSs and IASs. UK GAAP now consists of six standards that have been published by the Financial Reporting Council (FRC):

- FRS 100 Application of Financial Reporting Requirements
- FRS 101 Reduced Disclosure Framework
- FRS 102 The Financial Reporting Standards applicable in the UK and Republic of Ireland
- FRS 103 Insurance Contracts
- FRS 104 Interim Financial Reporting
- FRS 105 The Financial Reporting Standards applicable to the Micro-entities regime

FRS 100 provides direction on which standard and entity should be applying. FRS 101 applies to individual entities that prepare accounts under IFRS, in order to facilitate consolidation, that allows for reduced disclosure in the individual entity accounts.

FRS102 is based upon the IFRSs for SMEs and grouped into 34 separate chapters each one dealing with a particular accounting area and is used by UK unlisted groups (listed groups use full IFRS) and listed and unlisted individual entities.

FRS 105 cannot be applied by subsidiaries that are fully consolidated in group accounts or parent companies that prepare group accounts.



3. Key differences

The key differences between UK GAAP (FRS 102) and IFRS are summarised below:

IASB Conceptual Framework / Concepts and principles

International rules allow measurement using four bases (historic cost, present value, replacement cost and fair value), whilst FRS102 allows only two measurement bases (historic cost and fair value).

FRS102 separately identifies materiality, substance over form and prudence as qualitative characteristics, whereas they aren't in the IASB *Conceptual Framework*.

Recognition criteria are based on the probability and reliable measurement criteria only.

Financial statements presentation

FRS102 follows UK company law (Companies Act), but allows an option to use the format from IAS 1.

Inventories

Differences are that additional guidance is included on what is included within production overheads, and impairment losses can be reversed.

Cash flow statements

Minimal differences, with the headings being similar. FRS 102 allows some exemptions from preparing the cash flow statement

Accounting Policies, Estimates and Errors

IAS 8 states that a change in measurement from fair value to cost where there is no reliable measurement of fair value is a change in accounting policy.

Changes in accounting estimates result from changes to the current status of the asset/liability and its expected future benefits. The changes rise from new information or developments.

Events after the end of the Reporting Period

IFRS for SMEs discloses proposed dividends and it is recognised when declared. FRS102 allows dividends declared after the reporting date to be presented as separate component of retained earnings.

Property, plant and equipment

FRS102 reviews changes in residual value and useful lives when indicators of change are present. IFRS for SMEs requires annual reviews of the residual value and useful lives at the end of each reporting period.

Employee benefits

IFRS for SMEs and FRS 102 are very similar



Government grants

IFRS uses accrual model but FRS 102 gives a policy choice on the accruals and performance model, whereas IFRS for SMEs allows only the performance model.

FRS102 does not give guidance on the repayment of the grant, whereas IFRS for SMEs specifies that repayment goes to accrued income first and then any additional through profit or loss.

Borrowing costs

IFRS for SMEs must capitalise but FRS 102 allows an accounting policy choice with regards to capitalising or expensing the borrowing costs.

Related Party Disclosures

Transactions between the parent and a wholly owned subsidiary are exempt from disclosure under FRS102. Key management personnel disclosure is exempt for certain categories and type of benefit.

Income taxes

No significant differences in the treatment of current tax.

FRS 102 adopts a slightly different approach using a timing differences vs temporary differences approach. Timing differences are measured by comparing the PBT to PCTCT, as opposed to carrying value versus tax base under IFRS. The resulting deferred tax is very often the same.

FRS102 uses the concept of 'permanent difference', which is not specifically addressed in IFRS.

Foreign Currency Translation

A foreign currency translation reserve is not used in FRS102 and the gains/losses are not recycled.

Group Accounts (exclusion of subsidiary)

A subsidiary should be excluded from consolidation where:

- (a) Severe long-term restrictions substantially hinder the exercise of the rights of the parent over the assets or management of the subsidiary; or
- (b) The interest in the subsidiary is held exclusively with a view to subsequent resale; and the subsidiary has not previously been consolidated in the consolidated financial statements prepared in accordance with FRS 102.

NOTE: The Companies Act allows the exclusion of a subsidiary if consolidated financial statements cannot be obtained without disproportionate expense or undue delay.

Investments in Associates

Goodwill is recognised on acquisition of an associate/joint venture under FRS102, which is then amortised.



Impairment of assets

IAS 36 provides more detailed guidance than FRS102, and if there is no impairment indicator it is not necessary to estimate the recoverable amount.

Intangibles

Capitalisation of development costs is an accounting policy choice.

Intangibles are amortised over their useful life, and if an estimate cannot be made then the useful life is 10 years, whereas IFRS has indefinite life intangibles.

Investment property

Fair value through profit or loss for both IFRS and UK GAAP, if it is too costly to measure fair value then under FRS 102 it is carried at cost in PPE.

Share-based payments

FRS102 does not always apply the option pricing model, with the fair value measured using a three-tier measurement hierarchy. Choice of settlement is treated differently.

Goodwill

Transaction costs are capitalised under FRS102 but are expenses under IFRS for SMEs.

Contingent consideration is included within the cost of the investment under FRS102 if it is probable and can be measured reliably. It is recognised at fair value under IFRS for SMEs.

FRS102 uses the proportionate share method for calculating goodwill, whereas IFRS for SMEs uses both the fair value method and the proportionate share method.

Goodwill is amortised over its useful life, which if unable to be determined is taken as not exceeding ten years.

There is less detail on fair value measurement in FRS102 compared with IFRS for SMEs.

Discontinued operations and assets held for sale

FRS 102 does not account for assets held for sale, with the decision to sell being classified as an impairment indicator.

FRS102 shows the results of discontinued operations in a separate column in the income statement as opposed to in a single line item as under IFRS 5.

Financial instruments

FRS102 splits the rules on financial instruments into basic and other financial instruments, with basic being measured at amortised cost and other at fair value through profit or loss. There is no FVTOCI measurement basis.

FRS102 uses an incurred loss model compared to the expected loss model under IFRS 9, which results in earlier recognition of impairments under international rules.



There are different rules for hedge accounting under FRS102 but these are not examinable in SBR.

Revenue

There is no 5-step approach used in FRS 102.

NOTE: High level principles may be examined in a narrative question but detailed transactions will not be examined.

Leases

FRS102 follows the old rules of IAS 17 in that in the lessees books the lease is categorised as either a finance lease or an operating lease.

NOTE: High level principles may be examined in a narrative question but detailed transactions will not be examined.

Associates/Joint ventures

Classified differently whereby the equity method is not allowed for associates/joint ventures in individual financial statements.

4. Questions

1. Which of the following measurement bases are allowed by FRS102?
2. Which of the following measurement bases are not allowed by FRS102?
3. Where does FRS102 allow accounting policy choices whereas IFRS does not?
4. Explain the accounting treatment of goodwill under IFRS 3 Business Combinations and how it is different under FRS102.



5. Solutions

1. Historic cost and fair value
2. Current cost and present value
3. Accounting policy choices are allowed for both borrowing cost and development costs. Under FRS102 they can either be capitalised or expensed.
4. Goodwill is capitalised as an intangible non-current asset under both IFRS and UK GAAP, however its initial measurement and subsequent treatment is different

IFRS 3 allows the goodwill to be calculated using both the proportionate method and the fair value method. The proportionate share method measures the parent's goodwill only, whilst the fair value method results in a higher value as it includes the non-controlling interest goodwill also.

Negative goodwill is recognised immediately through profit or loss.

Goodwill is then subject to annual impairment reviews under IFRS.

FRS102 does not allow the fair value method for goodwill, whilst it is also amortised over its useful life. If this cannot be estimated, then it should not exceed ten years. Negative goodwill is recognised against positive goodwill on the statement of financial position, once its accuracy has been validated through remeasurement and reassessment of the elements of the calculation (cost and net assets).

6. Appendix 1: Comparison of UK and International syllabus

C. Reporting the financial performance of a range of entities

10. Reporting requirements of small entities

UK syllabus

- a) Discuss the financial reporting requirements for UK and Republic of Ireland entities (UK GAAP) and their interaction with the Companies Act requirements.
- b) Discuss the reasons why an entity might choose to adopt UK GAAP.
- c) Discuss the scope and basis of preparation of financial statements under UK GAAP.
- d) Discuss the concepts and pervasive principles set out by UK GAAP
- e) Discuss and apply the principal differences between UK GAAP and IFRS.

10. Reporting requirement of small and medium-sized entities (SMEs)

IFRS syllabus

- a) Discuss the accounting treatments not allowable under the IFRS for SMEs
- b) Discuss and apply the simplifications introduced by IFRS for SMEs



ANSWERS

Chapter 1 – IASB Conceptual Framework

Example Answer 1 – Framework

IAS 2 Inventories

Measurement - Valued at lower of cost and net realisable value

IAS 16 Property, plant and equipment

Measurement – Cost or revaluation model

IAS 37 Provision, contingent assets and contingent liabilities

Provision

Element – Liability (obligation)

Measurement – Present value (if materially different)

Contingent asset/liability

Element/Recognition – Disclosed in financial statements (possible obligation or probable inflow (prudence!))

IAS 38 Intangibles

Research – cannot capitalise (no probable future economic benefits)

Development – capitalise at cost (measure reliably and probable future economic benefits)

Chapter 2

Answer to example 1 - Regulatory Framework

Answer A

Answer to example 2 – Regulatory bodies

Answer C

Chapter 3

No examples



Chapter 4 – Basic Group Structures

Example Answer 1 – Influence

An associate is usually presumed if ownership of between 20% and 50% is evidenced, so initially it would appear that Vader does not have influence over Ren and is not therefor an associate.

Further investigation into the business relationship reveals a bit more with regards the level of influence that Vader actually exerts, regardless of the percentage ownership. Given that Vader has two seats on the board of directors then this will give them the ability to make themselves heard at board meetings and have influence over the decisions of the other six directors.

Vader should therefore treat Ren as an associated company and equity account for its 19.9% holding from the start of the year when it was acquired.

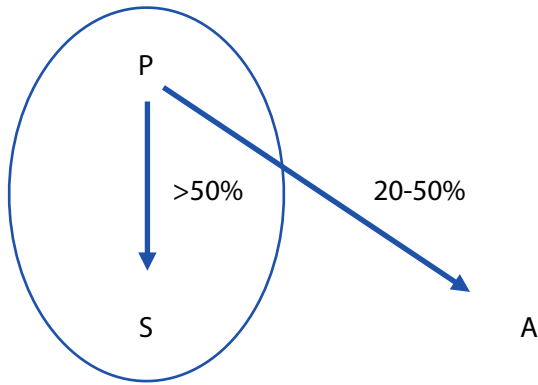
Example Answer 2 – Basic consolidation

	<i>Rey</i> <i>\$m</i>
Assets:	
Non-current assets	
Property, plant and equipment $(1,560 + 1,250 + (400 - 80) \text{ (W2)})$	3,130
Goodwill (W3)	45
Investment in associate (W6)	205
	<hr/> 3,380
Current assets:	
Inventory $(450 + 580)$	1,030
Receivables $(380 + 390)$	770
Cash $(190 + 230)$	420
	<hr/> 2,220
Total assets	<hr/> 5,600
Equity and liabilities:	
Share capital	1,700
Retained earnings (W5)	1,644
	<hr/> 3,344
Non-controlling interest (W4)	636
Total equity	3,980
Non-current liabilities $(520 + 350)$	870
Current liabilities	
Trade payable $(300 + 190)$	490
Tax payable $(150 + 110)$	260
	<hr/> 750
Total liabilities	<hr/> 1,620
Total equity and liabilities	<hr/> 5,600



Workings

W1) Group Structure



W2) Net assets of subsidiary

	<i>At reporting date</i>	<i>At acquisition</i>	<i>Post acquisition</i>
Equity shares	1,000	1,000	
SP			
Ret. earnings	800	450	
FV – PPE	400	400	
Depreciation	(80)	-	
	<u>2,120</u>	<u>1,850</u>	<u>270</u>

W3) Goodwill

FV of consideration (shares/cash/loan stock)	1,340
NCI at acquisition (30% x 1,850)	555
FV of net assets at acquisition (W2)	<u>(1,850)</u>
Goodwill at acquisition	<u>45</u>

W4) Non-controlling interests

NCI @ acq ⁿ (W3)	555
Add: NCI% x S's post-acq ⁿ profits (W2) (30% x 270)	<u>81</u>
	636

W5) Group retained earnings

100% P	1,450
Add: P's % of S's post acq ⁿ retained earnings (70% x 1,270(W2))	189
Add: P's % of A's post acq ⁿ retained earnings (W6)	10
Less: Dividend (W6)	<u>(5)</u>
	<u>1,644</u>

W6) Investment in associate

Cost	200
Add: P% x A's post-acq ⁿ profits (25% x 80 x 6/12)	10
Less: Dividend (25% x 20)	<u>(5)</u>
	205



Example Answer 3 – Other components of equity

(a) (i) Goodwill – proportionate share method

FV of consideration	5,400
NCI at acquisition (20% x 3,400)	680
FV of net assets at acquisition (W)	(3,400)
Goodwill at acquisition	<u>2,680</u>

(ii) Goodwill – fair value method

FV of consideration	5,400
NCI at acquisition	700
FV of net assets at acquisition (W)	(3,400)
Goodwill at acquisition	<u>2,700</u>

(b) Group retained earnings

100% P	3,200
Add: P's % of S's post acq ⁿ retained earnings (80% x 400(W))	320
	<u>3,520</u>

Group other components of equity

Cost	1,000
Add: P% x Ss post-acq ⁿ other comp. equity (80% x 225 (W))	180
	<u>1,180</u>

Workings

Net assets of subsidiary

	<i>At reporting date</i>	<i>At acquisition</i>	<i>Post acquisition</i>
Equity shares	2,000	2,000	
Ret. earnings	1,000	600	400
Other comp. equity	625	400	225
FV – Land	400	400	
	<u>4,025</u>	<u>3,400</u>	<u>625</u>



Example Answer 4 – Group SPLOCI**CONSOLIDATED STATEMENT OF PROFIT AND LOSS AND OTHER COMPREHENSIVE INCOME**

		6/12		
	<i>P</i>	<i>S</i>	<i>Adj.</i>	<i>Group</i>
Revenue	1,645	640	(20)	2,265
COS	(1,205)	(495)	20	(1,680)
Gross profit				585
Dist costs	(100)	(35)		(135)
Admin exp.	(90)	(25)		(121)
-Impairment		(6)		
Finance cost	(55)	(15)		(70)
Associate (25% x 100)				25
Profit before tax				284
Taxation	(35)	(14)		(49)
PFY		50		235
Revaluation gain	100	50		150
TCI		100		385
		Parent (β)		365
		NCI = 20% x 100		20

Workings

Goodwill	
FV of consideration	90
NCI at acquisition	25
FV of net assets at acquisition (W2)	(85)
Goodwill at acquisition	30

Example Answer 5 – Subsidiary impairment

Goodwill

	<i>\$'000</i>
FV consideration	20,000
FV NCI	15,000
FV net assets @ acquisition	(25,000)
Goodwill @ acquisition	10,000

Carrying value = FV net assets @ acquisition + post-acquisition profits + goodwill

Carrying value = \$25million + \$5million + \$10million = \$40million

FVLCTS = \$36million

VIU Recoverable amount (HIGHER) - \$38million

Impairment = \$40million - \$38million = \$2million.



Example Answer 6 – Associate impairment

Carrying value = \$5million + (25% x £2million) = \$5.5million

FVLCTS = 25% x \$16million = \$4million

VIU = 25% x \$20million = \$5million

Recoverable amount (HIGHER) = \$5million

Impairment = \$5.5million - \$5million = \$0.5million

Carrying value (@31.12.15) = \$5.5million - \$0.5million = \$5million

Chapter 5 – Joint Arrangements (IFRS 11)**Example Answer 1 – Joint operation****Lyon statement of profit or loss for the year-ended 31 December 2015**

	<i>\$'000</i>	<i>\$'000</i> <i>40%</i>
Revenue	30,000	12,000
Costs – direct	(22,000)	(8,800)
Costs – operating	(1,500)	(600)
Depreciation (15,000 / 10 years)	(1,500)	(600)
Profit		2,000

Lyon statement of financial position as at 31 December 2015

	<i>\$'000</i>
PPE (6,000 – 600)	5,400
Receivables	12,000
Payables (8,800 + 600)	9,400

Chapter 6 - Changes in group structure**Example Answer 1**

Goodwill

	<i>\$m</i>
FV consideration	45
FV of existing interest	52
FV NCI @ acquisition	32
FV net assets @ acquisition	(105)
Goodwill @ acquisition	24

A gain of \$12 million is also recorded in the group retained earnings, being the increase in fair value of the original investment from \$40 million to \$52 million.



Example Answer 2

DR	NCI	\$6.9m
DR	Other components of equity (β)	\$1.1m
CR	Bank	\$8m

NCI at acquisition	32.0
NCI% x S's post acquisition (25% x \$10m)	2.5
	<hr/> 34.5

Reduction on NCI = $5/25 \times 34.5 = \$6.9m$

Example Answer 3

DR	Bank	\$90m
CR	Non-controlling interest	\$80m
CR	Other components of equity (β)	\$10m

Increase in NCI = $20\% \times (\$350m + \$50m) = \$80m$

Example Answer 4

	\$m
Proceeds	120
Add: investment still held	96
Add: non-controlling interest	53
Less: net assets at disposal	(201)
Less: goodwill	(38)
Group profit on disposal	<hr/> 30



Example Answer 5 – Group SFP

(i) Goodwill

<i>Hulme</i>		<i>Jones</i>
75	FV of consideration	120
40	Add: NCI at acquisition	13
(105)	Less: N.A. at acquisition	(110)
<u>10</u>	Goodwill at acquisition	<u>23</u>

ii) Non-controlling interest

<i>Hulme (40%)</i>		<i>Jones (10%)</i>
40	NCI at acquisition	13
16 (40% x 40 (W2))	Add: NCI% x post-acquisition	1 (10% x 10 (W2))
<u>56</u>	NCI	<u>14</u>
(14) (10/40 x 56)		28.6
42		42.6

iii) Group retained earnings

100% P	110
Add: 60% x 40(W2)	24
Add: 90% x 10(W2)	9
Change in ownership (W4)	(1)
Change in ownership (W4)	<u>6.4</u>
	<u>135.6</u>

Workings

Net assets of Hulme

	<i>At reporting date</i>	<i>At acquisition</i>	<i>Post acquisition</i>
Equity shares	80	80	
Ret. earnings	<u>65</u>	<u>25</u>	<u>40</u>
	<u>145</u>	<u>105</u>	<u>40</u>

Net assets of Jones

	<i>At reporting date</i>	<i>At acquisition</i>	<i>Post acquisition</i>
Equity shares	75	75	
Ret. earnings	<u>45</u>	<u>35</u>	<u>10</u>
	<u>120</u>	<u>110</u>	<u>10</u>



Example Answer 6 – Group SPL

NCI = $[25\% \times 146 \times 3/12] + [35\% \times 146 \times 9/12] = \47.5 million.

Example Answer 7 – Group SPL

The initial 25% holding would have been treated as an associate and equity accounting used. The statement of financial position would show the investment in associate in non-current assets, shown as the cost plus 25% share of post-acquisition movement in Matthew's retained earnings. The statement of profit or loss would show the share of profit of associate, 25% of Matthew's profit for the year, immediately before profit before tax.

The acquisition of the additional 55% gives control as the parent now owns 80% and the associate becomes a subsidiary and is consolidated. The assets/liabilities and revenue/costs are added together 100% on a line-by-line basis. Goodwill on acquisition will be calculated alongside the non-controlling interest (20%) and group retained earnings for inclusion in the group statement of financial position.

The associate is removed from the accounts at its carrying amount, and the fair value of the shares previously held is included in the goodwill calculation. Any difference between the carrying amount and fair value goes through profit or loss.

The acquisition of the additional 10% to give 90% ownership is a change in ownership. The subsidiary is consolidated as previously, but there is a change in the NCI percentage, which has decreased from 20% to 10%. The difference between the amounts paid and the reduction in the NCI goes through retained earnings.

Chapter 7 – Foreign currency**Example Answer 1**

1 December 2015

DR	Purchases	\$97,561
CR	Payables	\$97,561

$$= \frac{400,000 \text{ Dinar}}{4.1} = \$97,561$$

31 December 2015

Retranslate the monetary balance (payable) at the closing rate (4.3 Dinar:\$1)

$$= \frac{400,000 \text{ Dinar}}{4.3} = \$93,023$$

Reduction in payables = $\$97,561 - \$93,023 = \$4,538$

DR	Payables	\$4,538
CR	Profit or loss	\$4,538

Do not retranslate the non-monetary balance (inventory), and leave it at \$97,561 at the reporting date.

10 January 2016

Translate the payment at the exchange rate on the day of the transaction

$$= \frac{400,000 \text{ Dinar}}{4.4} = \$90,909$$



DR	Payables	\$93,023
CR	Bank	\$90,909
CR	Profit or loss	\$2,114

Example Answer 2

	<i>Historic cost \$m</i>	<i>Revaluation model \$m</i>	<i>Revaluation reserve \$m</i>
Cost (1.1.11)	20		
= 72/3.6			
Acc. Depn. (20/25 years) x 5 years	(4)		
Carrying value (31.12.15)	16	22.1 = 95/4.3	6.1

Example Answer 3

(i) Goodwill

	<i>Dinars m</i>
FV of consideration	760
NCI at acquisition (20% x 500)	100
FV of net assets at acquisition (W2)	(500)
Goodwill at acquisition	360

Dinars 360 million @ 4.3 CR = \$83.7 million

Dinars 360 million @ 3.8 OR = \$94.7 million

Loss on goodwill = 83.7 – 94.7 = \$11.0 million

(ii) Post-acquisition reserves

	<i>Dinars m</i>	<i>Rate</i>	<i>\$m</i>
Non-current assets	500	@ CR	116.3
Current assets	390	@ CR	90.7
Total assets			207
Equity share capital	350	@ HR	92.1
Reserves			
- Pre-acquisition	150	@ HR	39.5
- Post-acquisition	130	(β)	15
Non-current liabilities	65	@ CR	15.1
Current liabilities	195	@ CR	45.3
Equity and liabilities			207



(iii) NCI

	<i>\$m</i>
NCI @ acq ⁿ (100 @ 3.8 HR)	26.3
Add: 20% x 15 (ii)	3
	<hr/> 29.3

(iv) Group retained earnings

	<i>\$m</i>
100% P	110
Add: 80% x 15 (ii)	12
Less: exchange loss on goodwill	(11)
	<hr/> 111

Example Answer 4 – gain or loss on translation of overseas subsidiary

			<i>\$m</i>
Opening net assets = 500 million Dinars			
	@ OR (3.8)	131.6	
	@ CR (4.3)	116.3	
			(15.3)
Profit for the year = 130 million Dinars			
	@ AR (4.0)	32.5	
	@ CR (4.3)	30.2	
			(2.3)
Goodwill = 360 million Dinars			
	@ OR (3.8)	94.7	
	@ CR (4.3)	83.7	
			(11.0)
Translation loss			<hr/> (28.6)

Any gains or losses on translation of the overseas subsidiary are recognised in other comprehensive income.



Example Answer 5 – Foreign currency and extracts from the financial statements**(a) Goodwill**

	<i>Dinar'000s</i>		<i>\$'000s</i>
FV of consideration (\$9,100,000 x 3.2 (HR))	29,120		
NCI at acquisition (\$1,800,000 x 3.2 (HR))	5,760		
	<u>34,880</u>		
FV of net assets at acquisition (10,800 + 4,000 (FV))	(14,800)		
Goodwill at acquisition	20,080	@3.2 (HR)	6,275
Exchange loss			(369)
Goodwill at reporting date (SFP)		@ 3.4 (CR)	<u>5,906</u>

Non-controlling interests

	<i>\$'000s</i>
NCI @ acq ⁿ	1,800
Add: NCI% x S's post-acq ⁿ profits (30% x 595)	179
Less: NCI% x exchange loss (30% x 369)	(111)
	<u>1,868</u>

Group retained earnings

	<i>\$'000s</i>
100% P	64,210
Add: P's % of S's post acq ⁿ retained earnings (70% x 595)	417
Less: P's% x exchange loss (70% x 369)	(258)
	<u>64,369</u>

Workings**(W) Post-acquisition reserves**

	<i>Dinars 000's</i>	<i>Rate</i>	<i>\$000's</i>
Book value of assets	39,750		
Fair value (4,000 – 800)	<u>3,200</u>		
Total assets	<u>42,950</u>	@ 3.4	<u>12,632</u>
Equity share capital			
Reserves	14,800	@ 3.2	4,625
- Pre-acquisition			
- Post-acquisition		(β)	595
Liabilities	25,200	@ 3.4	7,412
Equity and liabilities			<u>12,632</u>



(b) Consolidated statement of profit of loss (extracts)

	<i>Rory</i> \$'000s	<i>Noah</i> Dinar 000s	<i>Noah</i> \$'000s	<i>Group</i> \$'000s
Profit		2,300		
FV depn (4,000 / 10 years)		(400)		
		<hr/> 1,900		
Profit/(loss)	(1,400)	@3.6	528	872

Attributable to:

NCI (30% x 528)	158
Parent (β)	714

Consolidated statement of other comprehensive income (extracts)

			\$000s	\$000s
Opening net assets = Dinar 12,650,000 (=39,750,000 – 25,200,000 – 1,900,000)				
@ OR	3.9	3,244		
@ CR	3.4	3,721		
				477
Profit for the year = Dinar 1,900,000				
@ AR	3.6	528		
@ CR	3.4	559		
				31
Goodwill = Dinar 20,080,000				
@ OR	3.9	5,149		
@ CR	3.4	5,906		
				757
Translation gain				<hr/> 1,265



Chapter 8 – Group statement of cash flow

Example Answer 1

Non-controlling interest			
		B/f	110
Dividend paid (β)	1	Profit	6
C/f	115		
	<u>116</u>		<u>116</u>

Example Answer 2

Associate			
B/f	180		
Profit	20	Dividend paid (β)	10
		C/f	190
	<u>200</u>		<u>200</u>

Example Answer 3

	2015
	\$m
Operating activities	
Increase in inventory (W)	58
Increase in receivables (W)	(15)
Increase in payables (W)	20
Investing activities	
Acquisition of subsidiary, net of cash (50 – 5)	(45)

Working capital movement

	<i>Inventory</i>	<i>Receivables</i>	<i>Payables</i>
Opening	195	109	67
Acquisition/(disposal)	8	6	3
Expected	<u>203</u>	<u>115</u>	<u>70</u>
Closing (actual)	145	130	90
Movement	58↓	15↑	20↑



Example Answer 4

- (i) Dividend received from associate = \$30 million

	Associate	
B/f	190	
Profit	40	Dividend paid (β) 30
		C/f 200
	<u>200</u>	<u>200</u>

Or;

Dividend received = P's% x A's dividend paid = 20% x \$150 million = \$30 million

- (ii) Dividend paid to the non-controlling interests = \$20 million

- (iii) Net cash on acquisition of the subsidiary = \$47 million

Cash paid to acquire subsidiary = \$50 million

Less: cash in subsidiary = \$3 million

Net cash = \$47 million

- (iv)

	<i>\$m</i>
Operating Activities	
Group Profit Before Tax	375
Finance cost	55
Depreciation	130
Impairment	54
Profit on disposal of PPE	(7)
Share of Associates Profit	(40)
Inventory	70
Receivables	(51)
Payables	(139)
Cash generated from operations	<u>501</u>

Workings

Working capital movement

	<i>Inventory</i>	<i>Receivables</i>	<i>Payables</i>
Opening	580	390	430
Acquisition	20	15	9
Expected	<u>600</u>	<u>405</u>	<u>439</u>
Closing (actual)	530	456	300
Movement	70↓	51↑	139↓



Chapter 9 - Non-current assets

Example Answer 1 – Revaluation increase

<i>SFP</i>		<i>SPLOCI</i>	
	<i>\$'000</i>		<i>\$'000</i>
Property, plant and equipment	89,412	Depreciation	5,588
Revaluation reserve	25,412	Gain	27,000

	<i>Historic cost (\$'000)</i>	<i>Revaluation model (\$'000)</i>	<i>Revaluation reserve (\$'000)</i>
Cost (1.1.12)	80,000		
Acc. Depn. (80,000/20) x 3 years	(12,000)		
Carrying value (31.12.14)	68,000	95,000	27,000
Depreciation (95,000/17)	(4,000)	(5,588)	(1,588)
		89,412	25,412

Example Answer 2 – Revaluation decrease

<i>SFP</i>		<i>SPLOCI</i>	
	<i>\$'000</i>		<i>\$'000</i>
Property, plant and equipment	8,000	Depreciation	1,750
		Impairment	400
		Impairment	3,850

	<i>Historic cost (\$'000)</i>	<i>Revaluation model (\$'000)</i>	<i>Revaluation reserve (\$'000)</i>
Cost (1.1.13)	12,000		
Acc. Depn. (12,000/10) x 2 years	(2,400)		
Carrying value (31.12.14)	9,600	14,000	4,400
Depreciation (14,000/8)	(1,200)	(1,750)	(550)
Carrying value (before)	8,400	12,250	3,850
Impairment	(400)	(4,250)	(3,850)
Carrying value (after)		8,000	Nil



Example Answer 3 – Change in estimate

	<i>SFP</i> <i>\$'000</i>		<i>SPLOCI</i> <i>\$'000</i>
Property, plant and equipment	14,000	Depreciation	3,500

	<i>\$'000</i>
Cost (1.1.12)	25,000
Acc. Dep. (25,000/10) x 3 years	(7,500)
Carrying value (31.12.14)	<hr/> 17,500
Depreciation 17,500/5	(3,500)
	<hr/> 14,000

Example Answer 4 – Specific borrowings

$$\begin{aligned}\text{Borrowing costs} &= \$10 \text{ million} \times 5\% \times 9/12 \\ &= \$375,000\end{aligned}$$

Example Answer 5 – General borrowings

	<i>%</i>	<i>\$m</i>	<i>Ave.</i>
4% bank loan	4%	25	1
3% bank loan	3%	40	1.2
		<hr/> 65	<hr/> 2.2

$$\text{Weighted average} = \frac{2.2}{65} \times 100\%$$

$$= 3.38\%$$

$$\begin{aligned}\text{Capitalised} &= (\$10\text{m} \times 3.38\%) + (\$15\text{m} \times 3.38\% \times 6/12) \\ &= \$0.59\text{m}\end{aligned}$$

Example Answer 6 – Grants and depreciable assets

The property, plant and equipment will be capitalised on the statement of financial position as a non-current asset at its cost of \$10 million.

It will be depreciated over its 10 year useful life and therefore \$1 million of depreciation will be charged through profit or loss each year. The carrying value of the PPE will be reduced by the same amount each year.

The government grant is for a depreciable asset and so the \$2 million will be spread over the same life as the PPE.

As Tweddle has met the conditions for the grant the \$2 million will be recognised as deferred income on the statement of financial position.

It will be spread/amortised over 10 years and therefore \$0.2 million income will be shown in profit or loss each year, with the deferred income being reduced by the same amount each year.

Tweddle will also split the deferred income at the reporting date between current and non-current liabilities.



The statement of cash flows will show a payment to acquire PPE of \$10 million and grant income of \$2 million in investing activities.

The depreciation and amortisation of government grants are both non-cash items in profit or loss and will need adjusting in operating activities if using the indirect method.

Example Answer 7 – Investment property and change of use

Addington will treat the property using IAS 16 for the first six-months of the year before applying IAS 40 once the change in use of the property took place.

The property will be depreciated for the first six-months of the year resulting in a depreciation expense through profit or loss of \$0.5 million ($\$20 \text{ million} / 20 \text{ years} \times 6/12$), thus reducing the carrying value to \$19.5 million ($\$20 \text{ million} - \0.5 million).

The property is revalued to its fair value of \$21 million on 1 July 2015 under IAS 16, giving a gain through other comprehensive income of \$1.5 million ($\$21 \text{ million} - \19.5 million).

The property is now classified as investment property and no longer depreciated.

It is revalued to a fair value of \$21.6 million at the reporting date with the gain of \$0.6 million going through profit or loss.

Chapter 10 – Intangible assets

Example Answer 1 – Intangibles

The purchase of the patent should be capitalised at \$15 million and amortised over its useful life.

The \$6 million spent on the investigative phase is essentially research and should be expensed through profit or loss as incurred.

The \$8 million subsequently spent after completion of the research phase is development expenditure and is capitalised as an intangible non-current asset on the statement of financial position.

It is not yet amortised as the project is not yet complete but an impairment review should be carried out to see if the asset has lost value.

The \$1.5 million spent on marketing and training should both be expensed through profit or loss immediately.

Chapter 11 - Impairments

Example Answer 1 – CGU impairment

The plant and equipment is reduced in value to \$4 million ($\$5.2 \text{ million} - \1.2 million) as it has been specifically impaired following the destruction by fire of some of the equipment.

The goodwill is then fully impaired and written down to a nil carrying value.

The patent is reduced in value to \$1.5 million

The remaining impairment is then \$3.1 million ($\$17 \text{ million} - \9.8 million (recoverable amount of CGU) - $\$1.2 \text{ million}$ (plant & equipment) - $\$2.4 \text{ million}$ (goodwill) - $\$0.5 \text{ million}$ (patent)), which is spread pro-rate over the remaining assets. As the receivables and cash are held at their realisable values they will not be impaired and so the remaining impairment is fully allocated to the buildings.



Chapter 12 – Non-current assets held for sale and discontinued operations

Example Answer 1 – NCA-HFS

	<i>SFP</i> <i>\$'000</i>		<i>SP/OCI</i> <i>\$'000</i>
Current assets		Depreciation	100
NCA-HFS	15,100	OCI	
		Gain on revaluation	1,400

Workings

	<i>Historic cost</i> <i>\$000s</i>	<i>Revaluation model</i> <i>\$000s</i>	<i>Revaluation</i> <i>reserve</i>
Revalued amount	14,000		
Depreciation 300 x 4/12	(100)		
	13,900	15,100 (=15,400 – 300)	1,400

Example Answer 2 – Discontinued operations

31 December 2015

The operation is not being sold so cannot be classified as held for sale and neither is it a discontinued operation as it is still operating until 31 March 2016. Angola is firmly committed to the closure but it hasn't taken place and so is included in continuing operations. A disclosure in the notes can be made of the intention to close the operation in the following year.

31 December 2016

The operation is now classified as a discontinued operation as it has now ceased operating.



Chapter 13 - Employee Benefits

Example Answer 1 – Defined benefit scheme

Statement of financial position (extract)

	\$m
Fair value of scheme assets	66
Fair value of scheme liabilities	(75)
Net pension asset/(liability)	(13)

Statement of profit or loss and other comprehensive income (extract)

	\$m
Profit or loss	
Operating costs	
Current service costs	(9)
Past service costs	(8)
Financing costs	
Interest expense (W)	(3.2)
Return on investment (W)	3
Other comprehensive income	
Re-measurement gain (W)	7.2

Workings

Assets	\$m	Liabilities	\$m
Opening	60	Opening	64
Return on investment (60 x 5%)	3	Interest (64 x 5%)	3.2
Contributions paid in	5	Service costs (9 + 8)	17
Benefits paid out	(6)	Benefits paid out	(6)
Expected	62	Expected	78.2
Re-measurement component (β)	4	Re-measurement component (β)	(3.2)
Closing (per actuary)	66	Closing (per actuary)	75

Example Answer 2 – Curtailment

The re-organisation has led to redundancies and therefore a significant number of employees will have left the scheme as they are no longer entitled to earn any future pension benefits.

The net liability on the statement of financial position will be \$7 million (\$48 million - \$55 million) and a gain will be shown through profit or loss of \$5 million, being the reduction in the liability (\$60 million - \$55 million).

Example Answer 3 – Asset ceiling

The asset ceiling is the present value of the reductions in future contributions, above which the value of the net pension asset cannot be recognised above.

The pension asset is currently above the asset ceiling so must be reduced to \$26 million and the reduction in value of \$4 million (\$30 million - \$26 million) shown as a loss through profit or loss.



Chapter 14 – Share based payments

Example Answer 1 – Fair value equity settled (services)

Statement of financial position (extract)

	31 Dec'15	31 Dec'16	31 Dec'17
Other components of equity (W)	\$800,000	\$1,600,000	\$2,400,000

Statement of profit or loss (extract)

	31 Dec'15	31 Dec'16	31 Dec'17
Expense (= movement)	\$800,000	\$800,000	\$800,000

Workings

31 December 2015

$$\begin{aligned} \text{Obligation} &= 10,000 \text{ options} \times 20 \text{ employees} \times \$12 \times \frac{1}{3} \\ &= \$800,000 \end{aligned}$$

31 December 2016

$$\begin{aligned} \text{Obligation} &= 10,000 \text{ options} \times 20 \text{ employees} \times \$12 \times \frac{2}{3} \\ &= \$1,600,000 \end{aligned}$$

31 December 2017

$$\begin{aligned} \text{Obligation} &= 10,000 \text{ options} \times 20 \text{ employees} \times \$12 \times \frac{3}{3} \\ &= \$2,400,000 \end{aligned}$$



Example Answer 2 – Options to be exercised (equity settled)**Statement of financial position (extract)**

	31 Dec'14	31 Dec'15
Other components of equity (W)	\$2,400,000	\$7,200,000

Statement of profit or loss (extract)

	31 Dec'14	31 Dec'15
Expense (= movement)	\$2,400,000	\$4,800,000

Workings**31 December 2014**

$$\begin{aligned} \text{Obligation} &= 20,000 \text{ options} \times (10 - 4) \text{ employees} \times \$60 \times \frac{1}{3} \\ &= \$2,400,000 \end{aligned}$$

31 December 2015

$$\begin{aligned} \text{Obligation} &= 20,000 \text{ options} \times (10 - 1) \text{ employees} \times \$60 \times \frac{2}{3} \\ &= \$7,200,000 \end{aligned}$$

Example Answer 3 – Fair value equity settled (goods)

The transaction involves an equity settled share based payment for goods as the supplier has the right to receive shares in Caerphilly in return for the transfer of goods.

As it is an equity settled share based payment the fair value of the goods at \$10 million should be used to record the transaction.

DR	Purchases/inventory	\$10 million
CR	Other components of equity	\$10 million



Example Answer 4 – Fair value cash settled**Statement of financial position (extract)**

	<i>31 Dec'15</i>	<i>31 Dec'16</i>	<i>31 Dec'17</i>
Liability (W)	\$900,000	\$1,840,000	\$2,840,000

Statement of profit or loss (extract)

	<i>31 Dec'15</i>	<i>31 Dec'16</i>	<i>31 Dec'17</i>
Expense (= movement)	\$900,000	\$940,000	\$1,000,000

Workings**31 December 2015**

$$\begin{aligned} \text{Obligation} &= 10,000 \text{ options} \times 20 \text{ employees} \times \$13.50 \times \frac{1}{3} \\ &= \$900,000 \end{aligned}$$

31 December 2016

$$\begin{aligned} \text{Obligation} &= 10,000 \text{ options} \times 20 \text{ employees} \times \$13.80 \times \frac{2}{3} \\ &= \$1,840,000 \end{aligned}$$

31 December 2017

$$\begin{aligned} \text{Obligation} &= 10,000 \text{ options} \times 20 \text{ employees} \times \$14.20 \times \frac{3}{3} \\ &= \$2,840,000 \end{aligned}$$



Example Answer 5 – Options to be exercised (cash settled)**Statement of financial position (extract)**

	31 Dec'14	31 Dec'15
Liability (W)	\$3,200,000	\$8,000,000

Statement of profit or loss (extract)

	31 Dec'14	31 Dec'15
Expense (= movement)	\$3,200,000	\$4,800,000

Workings**31 December 2014**

$$\begin{aligned} \text{Obligation} &= 20,000 \text{ options} \times (10 - 4) \text{ employees} \times \$80 \times \frac{1}{3} \\ &= \$3,200,000 \end{aligned}$$

31 December 2015

$$\begin{aligned} \text{Obligation} &= 20,000 \text{ options} \times (10 - 2) \text{ employees} \times \$75 \times \frac{2}{3} \\ &= \$8,000,000 \end{aligned}$$

Example Answer 6 – Vesting conditions

The scheme contains both market based and non-market based vesting conditions.

The market based condition where the share price needs to be \$15 at the vesting date is ignored over the vesting period. It is only taken into consideration on 31 December 2017 when the condition is either fulfilled or not fulfilled.

The non-market based vesting condition is accounted for over the vesting period as normal. The fair value at the grant date is therefore spread over the three year vesting period.

The obligation at 31 December is \$100,000 (=5,000 options x 5 employees x \$12 x 1/3) so therefore an equity balance of \$100,000 will be shown on the statement of financial position.

As it is the first year of the scheme the statement of profit or loss will be shown and expense for the same amount.



Chapter 15 – Financial instruments

Example Answer 1 – Equity or debt?

Although there is an option to redeem the shares for cash, the financial instrument will be treated as equity.

The redemption offers the option of converting for 'A' shares which even at their lowest recent price of \$2, is still comfortably above their par value of \$1. This would therefore make the conversion to 'A' shares the more attractive offer and there is therefore no obligation to pay cash and hence classified as equity.

Example Answer 2 – Financial assets

- The investment in shares is initially recognised at \$500,000 on the statement of financial position as an asset.

The transaction costs are recognised immediately through profit or loss as the shares are classified as fair value through profit or loss.

At the reporting date the shares are re-measured to their fair value of \$350,000 on the statement of financial position.

A loss on the investment is recognised through profit or loss of \$150,000.
- The investment in shares is initially recognised at \$540,000 on the statement of financial position as an asset.

The transaction costs are included in the value of the asset as it is held strategically for the long-term and therefore classified as fair value through other comprehensive income.

At the reporting date the shares are re-measured to fair value of \$620,000 on the statement of financial position.

The gain on the investment of \$80,000 is shown through other comprehensive income.

On disposal of the shares a gain of \$30,000 is recognised through profit or loss and the \$80,000 held in other comprehensive income is recycled through profit or loss.
- The investment in debt is classified as amortised cost as there are contractual coupon interest receipts each year and the intent is to hold the asset until all the cash has been collected.

The investment in debt is initially measured at \$980,000 on the statement of financial position.

The effective rate of interest is used to calculate the interest income each year. In the first year the interest income is \$55,958 ($\$980,000 \times 5.71\%$) and is recognised through profit or loss.

The cash receipts of \$40,000 are used to reduce the value of the investment on the statement of financial position.

The investment in debt is held at \$995,958 at the reporting date on the statement of financial position.



Example Answer 3 – Financial liabilities**SPL**

	<i>Year 1</i>	<i>Year 2</i>	<i>Year 3</i>	<i>Year 4</i>
Finance cost	87	89	91	93

SFP

	<i>Year 1</i>	<i>Year 2</i>	<i>Year 3</i>	<i>Year 4</i>
2% debentures (W)	1,947	1,996	2,047	-

Working

<i>Year</i>	<i>B/f</i>	<i>Interest (4.58%)</i>	<i>Cash</i>	<i>C/f</i>
1	1,900	87	(40)	1,947
2	1,947	89	(40)	1,996
3	1,996	91	(40)	2,047
4	2,047	93	(2,140)	-

Example Answer 4 – Convertible debentures

Alice is required to account for the convertible debentures on initial recognition based on substance and using split equity accounting.

The net proceeds are recorded at \$99 million (\$100 million less \$1 million issue costs).

The liability is calculated on the assumption that there is no conversion option on the debt, so essentially treated as a 100% loan redeem for cash. The initial liability is recognised at the present value of the future cash flows, discounted at the rate of interest on similar debt without the conversion option. This gives a figure of \$94.8 million (see working below).

The difference between the liability and the net proceeds is recognised within equity at \$5.2 million.

The issues costs will be split between the liability and equity in proportion to the weighting of the liability and equity as follows:

$$\text{Liability} = 94.8 - (0.948 \times 1) = 93.9$$

$$\text{Equity} = 5.2 - (0.052 \times 1) = 5.15$$

The subsequent accounting treatment of the debt is at amortised cost using the effective rate of 6.34% to calculate the effective interest, whilst the equity balance is not adjusted until conversion takes place in the future.

Working

<i>Year</i>	<i>Cash flow (\$m)</i>	<i>DF (@ 7.67%)</i>	<i>PV (\$m)</i>
1	4 (4% coupon x \$100 million (par))	0.943	3.8
2	4	0.890	3.6
3	104 (\$4m plus \$100 million (par at redemption))	0.840	87.4
			<hr/> 94.8 =\$94.8 million



Chapter 16 – Fair Value (IFRS 13)

No examples

Chapter 17 – Operating segments

Example Answer 1 – Operating segments

An operating segment is one whose results are regularly reviewed by the chief operating decision maker (CODM). The three segments reviewed by the CODM are therefore three operating segments.

Two or more operating segments may be combined if they have similar economic characteristics. So to combine the domestic operations and the international operations the two segments would need to have similar levels of risk.

The biggest risk that is faced by Gulf within the two segments is the price risk. The revenue from the domestic railways is regulated by the transport authority, so is subject to a different risk from the international railways where it is determined by Gulf itself.

The other risk is from the offering of the contracts. The domestic railway contracts are awarded from the transport authority whereas the international railway contracts are not awarded by any authority and so both are subject to different levels of risk.

The operating segment disclosure note should therefore disclose the three segments separately within the notes to the accounts.

Chapter 18 – Revenue from contracts with customers (IFRS 15)

Answer to example 1 – Transaction price

The three-year interest-free credit period suggests that the \$10,000 selling price includes a significant financing component.

The selling price is therefore discounted to present value based on a discount rate that reflects the credit characteristics of the party (customer) receiving the financing i.e. 5%.

Therefore the transaction price is $\$10,000 / (1.05)^3 = \$10,000 \times 0.8638 = \$8,638$.

Answer to example 2 – Allocation of price

The performance obligations and allocation of total price are as follows:

Provision of home cinema system $(9,000 / 11,000 \times \$10,000) = \$8,182$

Provision of maintenance contract $(2,000 / 11,000 \times \$10,000) = \$1,818$



Answer to example 3 – IFRS 15 (1)

1. Identify the contract
 - Signed agreement
2. Identify the separate performance obligations
 - Sale of handset
 - Provision of calls and data service
3. Determine the transaction price
 - $\$540 = \$45 \times 12 \text{ months}$
4. Allocate transaction price to performance obligations
 - Standalone prices (using Vodaphone)
 - $\$720 (= \$480 + (12 \text{ months} \times \$20))$
 - Handset = $480/720 \times 540 = \$360$
 - Calls and data = $240/720 \times 540 = \$180$
5. Recognise revenue as each performance obligation is satisfied
 - Handset (goods) = at
 - Calls and data (services) = over 12 months

Answer to example 4 – IFRS 15 (2)

1. Identify the contract
 - Signed agreement
2. Identify the separate performance obligations
 - Supply and installation service
 - Technical support
3. Determine the transaction price
 - Combined contract price = \$1,600
4. Allocate transaction price to performance obligations
 - Standalone price(supply and installation) = \$1,500
 - Standalone price (technical support) = \$500
 - Supply and installation = $1,500/2,000 \times 1,600 = \$1,200$
 - Technical support = $500/2,000 \times 540 = \$400$
5. Recognise revenue as each performance obligation is satisfied
 - Supply and installation = on installation (1 July 20X7)
 - Technical support = over two years (1 July 20X7 to 30 June 20X9)

SFP (extract)

	\$
Non-current liabilities	
Deferred income	100
Current liabilities	
Deferred income	200
	= $12/24 \times 400$

SPL (extract)

	\$
Revenue	1,300
	= $1,200 + (6/24 \times 400)$



Answer 5 – Performance obligations over time and the statement of profit or loss (1)

	<i>\$m</i>
Revenue (= work certified in year)	15.0
Cost (β)	<u>(9.2)</u>
Profit (9.1 (W) – 3.3)	5.8

Workings

	<i>\$m</i>
Total revenue	45.0
Total costs (20.0 + 12.0)	<u>(32.0)</u>
Profit	13.0
@ 70%	9.1

Answer 6 – Performance obligations over time and the statement of profit or loss (2)

	<i>\$m</i>
Revenue (45% x 40)	18.0
Cost (β)	<u>(23.0)</u>
Loss (100%)	(5.0)

Workings

	<i>\$m</i>
Total revenue	40.0
Total costs (25.0 + 20.0)	<u>(45.0)</u>
Loss	(5.0)

Answer 7 – Performance obligations over time and the statement of financial position

Statement of profit or loss (extract)

	<i>\$000</i>
Revenue (40% x 140,000)	56,000
Cost (β)	<u>(43,200)</u>
Profit	12,800

Statement of financial position (extract)

Current assets

	<i>\$</i>
Costs incurred to date	52,000
Recognised profits	12,800
Recognised losses	(-)
Progress billings to date	<u>(45,000)</u>
Gross amount due from/(to) customers	19,800
Receivables (45,000 – 26,500)	18,500

Workings

	<i>\$000s</i>
Total revenue	140,000
Total costs (60,000 + 48,000))	(108,000)
Profit	32,000
@ 40%	12,800

Chapter 19 – Leases**Answer 1 – Low-value assets**

An expense of \$1,500 would be recognised through profit or loss for each of the four year lease. At the end of year one an accrual of \$1,500 would be recognised on the statement of financial position of which \$500 would be released over the remaining three years of the lease.

$$\text{Expense (p.a.)} = \frac{\$2,000 \times 3}{4} = \$1,500$$

Answer 2 – Identifying a lease

1. The identified asset is the specific rail cars in the contract to which the supplier does not have substantive substitution rights (unless for repairs or maintenance). The customer has exclusive use of the rail cars so has the right to all the economic benefits. The contract therefor contains a lease of the rail cars.
2. There is no identified asset as the supplier can use any rail car as long as it meets the specific type as designated in the contract, which means that the supplier has substantive substitution rights. As the supplier can choose which rail car to use out of a fleet then they have substantially all of the economic benefit of the rail car and hence there is no lease within the contract.

Answer 3 – Lease and non-lease components

Pear will allocate \$90,476 as the lease rental and apply this using IFRS 16 (right-of-use asset and lease liability), whilst the \$9,524 will be recognised through profit or loss each year.

	<i>Stand-alone price</i>		<i>Allocated</i>
	<i>\$</i>		<i>\$</i>
Machinery (lease)	95,000	90.48% (=95/105)	90,476
Maintenance (non-lease)	10,000	9.52% (10/105)	9,524
Total	105,000	100.0%	100,000



Answer 4 – Lessee accounting

Initial recognition

- Record the right of use asset and lease liability

DR	Right-of-use asset	\$22,730
CR	Lease liability	\$22,730

- Record the initial direct costs

DR	Right-of-use asset	\$1,000
CR	Cash	\$1,000

- Record the incentive payments received

DR	Cash	\$500
CR	Right-of-use asset	\$500

Right-of-use asset = $22,730 + 1,000 - 500 = 23,230$

Subsequent measurement

Depreciate the asset over the earlier lease term of five years.

$$\text{Expense (p.a.)} = \frac{\$23,230}{5} = \$4,646$$

Record finance lease payments and interest using the rate implicit in the lease

<i>Year</i>	<i>B/f</i>	<i>Payment</i>	<i>Capital balance</i>	<i>Finance cost (5%)</i>	<i>C/f</i>
1	22,730	-5,000	17,730	887	18,617
2	18,617	-5,000	13,617	681	14,298
3	14,298	-5,000	9,298	465	9,763
4	9,763	-5,000	4,763	237	5,000
5	5,000	-5,000	-	-	-

Answer 5 - Lessor accounting

Income of \$1,500 would be recognised through profit or loss for each of the four year lease. At the end of year one, accrued income of \$1,500 would be recognised on the statement of financial position of which \$500 would be released over the remaining three years of the lease.



Answer 6 – Lessor accounting

Unguaranteed residual value = \$2,000 - \$1,600 = \$400

Gross investment in the lease = (\$5,000 x 5 years) + \$400 = \$25,400

Net investment in the lease = \$23,484 (W)

Year		DF 4%	PV
0	5,000	1	5,000
1	5,000	0.962	4,810
2	5,000	0.925	4,625
3	5,000	0.889	4,445
4	5,000	0.855	4,275
5	400	0.822	329
			23,484

Answer 7 – Sale and leaseback (1)

(i) Transfer of asset is not a sale

Seller

- Continue to recognise the asset @ \$8.4 million and depreciate.
- Recognise a financial liability @ transfer proceeds of \$10 million.

Lessor

- Do not recognise the asset as it has not been sold to the buyer.
- Recognise a financial asset @ transfer proceeds of \$10 million.

(ii) Transfer of asset is sale

Seller

- Derecognise the asset @ \$8.4 million¹
- Recognise lease liability @ PV of lease rentals²
- Recognise a right-of-use asset, as a proportion of the previous carrying value of underlying asset³
- Gain/loss on rights transferred⁴

Lessor

- Recognise purchase of the asset @ \$10 million (fair value = proceeds)
- Apply lessor accounting

DR Bank	\$10,000,000	
DR Right of use asset ³ (W2)	\$6,486,257	
CR Lease liability ² (W1)		\$7,721,735
CR PPE – Building ¹		\$8,400,000
CR Gain on transfer ⁴		\$364,522

(W1) Lease liability = PV of lease rentals at rate implicit in the lease = \$1 million x AF_{1-10@5%}

Lease a = \$1 million x 7.722 = \$7,721,735

(W2)	\$		\$
Right-of-use retained	7,721,735	77.22%	6,486,257
Rights transferred	2,278,265	22.78%	1,913,743
Total	10,000,000	100.0%	8,400,000



Answer 8 – Sale and leaseback (2)

- i) The proceeds of \$9 million are below the \$10 million fair value of the asset and so the below-market proceeds of \$1 million are treated as a prepayment.

DR Bank	\$9,000,000	
DR Prepayment	\$1,000,000	
DR Right of use asset ³ (W2)	\$6,486,257	
CR Lease liability ² (W1)		\$7,721,735
CR PPE – Building ¹		\$8,400,000
CR Gain on transfer ⁴		\$364,522

- ii) The proceeds of \$11 million are greater than the \$10 million fair value of the asset, so the above market proceeds are treated as additional financing provided by the buyer-lessor to the seller-lessee.

DR Bank	\$11,000,000	
DR Right of use asset ³ (W2)	\$6,486,257	
CR Lease liability ² (W1)		\$8,721,735
CR PPE – Building ¹		\$8,400,000
CR Gain on transfer ⁴		\$364,522

Chapter 20 Inventory and agriculture**Example Answer 1 – Agriculture**

The cows are initially recognised at \$1.50 million being the price paid (fair value in an active market less purchase costs). The cows are measured at fair value under IAS 41 as they are biological assets.

At year-end the total fair value less point of sale costs is \$1,650,100 ($1,000 \times \$1,650.10$), which will be shown as a non-current asset in the statement of financial position.

The movement increase in fair value of \$170,100 ($\$1,650,100 - \$1,480,000$) goes through profit or loss.

Disclosure of the price change ($\$1,550.25 - \$1,500.00$) and physical change ($\$1,650,10 - \$1,550.25$) can be made in the notes to the accounts.

Example Answer 2 – Inventory

	\$
Selling price	1,450
Less: selling costs	(10)
NRV	1,440
Less: conversion costs	(500)
NRV (1 st stage)	940

Write down:

		\$m
Finished goods	200,000 units \times ($1,500 - 1,440$)	12
First stage of production	100,000 units ($1,000 - 940$)	6



Chapter 21 – Deferred tax

Example Answer 1 – Accelerated capital allowances

1. Calculate the temporary difference

	Year 1	Year 2	Year 3
	\$	\$	\$
Carrying value	130,000	110,000	90,000
Tax base	112,500	84,375	63,281
Temporary difference	17,500	25,625	26,719

2. Calculate the deferred tax position

	Year 1	Year 2	Year 3
	\$	\$	\$
Temporary difference	17,500	25,625	26,719
Deferred tax position @20%	3,500	5,125	5,344

3. Deferred tax asset/liability?

	Year 1	Year 2	Year 3
	\$	\$	\$
CV > TB	CV > TB	CV > TB	CV > TB
DT Liability	DT Liability	DT Liability	DT Liability
3,500	5,125	5,344	

4. Movement in opening and closing position

	Year 1	Year 2	Year 3
	\$	\$	\$
Closing position	3,500	5,125	5,344
Opening position	Nil	3,500	5,125
Movement	3,500	1,625	219
	↑ Liability	↑ Liability	↑ Liability

Example Answer 2 – Share based payments

	Year 1
	\$
Carrying value	(40,000)
(1,000 SBP x 100 employees x \$1.60 (intrinsic) x ¼)	
Tax base	Nil
Temporary difference	40,000
Deferred tax position @20%	8,000
	DT Asset
	(CV < TB)



Example Answer 3 – Revaluations

There is a gain on revaluation at the year-end of \$320,000 (\$800,000 - \$480,000) that is shown through other comprehensive income.

The deferred tax is calculated in the standard fashion but the carrying value is based upon the revalued amount.

	<i>Year 1</i>
	\$
Carrying value (revalued amount)	800,000
Tax base	420,000
Temporary difference	380,000
Deferred tax position @20%	76,000
	Liability (CV > TB)

The deferred tax liability must be recorded at \$76,000 at the end of the first year but careful consideration must be given to the movement in the deferred tax liability as it is higher than what it is expected to be given the asset was revalued.

DR	Profit or loss (β)	12,000
DR	Other comprehensive income (\$320,000 gain on revaluation x 20%)	64,000
CR	Deferred tax liability	76,000

Chapter 22

No examples

Chapter 23 – Provisions, contingent liabilities and contingent assets**Example Answer 1 – Provisions and contingent liabilities**

York should record a provision for \$15 million to cover all of the three major projects that have environmental clean-up costs.

York has created a constructive obligation to clean-up any environmental damage, regardless of whether there is a law enforcing it, as it has a clear communicated policy on its website and in its annual report.

If York had not created the constructive obligation then it would only have provided for the \$4 million as here there is a law enforced, creating a legal obligation.

Chapter 24 – 33

No examples



