MARK PLAN AND EXAMINER'S COMMENTARY

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

Question 1

Total Marks: 30

General comments

Part 1.1 of this question tested the preparation of a statement of profit or loss, a statement of financial position and a property, plant and equipment movement note from a set of draft financial statements. Adjustments included several transactions in respect of property, plant and equipment (a revaluation in the year, purchase of an asset in a foreign currency, depreciation charges for the year and an asset held for sale), a financial instrument and an income tax refund. Part 1.2 tested the two fundamental qualitative characteristics, and the trade-off between them, illustrated with reference to the financial statements prepared in Part 1.1.

Pisa Ltd

1.1 Financial statements

(a) Statement of profit or loss for the year ended 31 December 2015

	£
Revenue	2,521,200
Cost of sales (W1)	(1,157,017)
Gross profit	1,364,183
Administrative expenses (W1)	(594,800)
Other operating costs (W1)	(251,000)
Profit from operations	518,383
Finance cost (W7)	(31,500)
Profit before tax	486,883
Income tax expense (123,000 – 5,500)	(117,500)
Profit for the year	369,383

(b) Statement of financial position as at 31 December 2015

	£	£
Assets		
Non-current assets		
Property, plant and equipment (2,257,500 + 613,093 (c))		2,870,593
Current assets		
Inventories	849,300	
Trade and other receivables	478,230	
Cash and cash equivalents	13,600	
	1,341,130	
Non-current asset held for sale (9,000 – 600)	8,400	
		1,349,530
Total assets		4,220,123

	£	£
Equity and liabilities		
Equity		
Ordinary share capital		1,000,000
Revaluation surplus (W6)		995,250
Retained earnings (W5)		1,213,173
		3,208,423
Non-current liabilities		
Preference share capital (6% redeemable) (W7)		501,500
Current liabilities		
Trade and other payables (392,500 – 5,300 (W3))	387,200	
Taxation	123,000	
		510,200
Total equity and liabilities		4,220,123

(c) Property, plant and equipment note

	Land and buildings £	Plant and equipment £
Valuation/Cost		
At 1 January 2015	1,847,500	789,600
Revaluation (2,300,000 – 1,847,500)	452,500	
Additions (247,450 + 5,300 (W3))		252,750
Classified as held for sale		(20,000)
	2,300,000	1,022,350
Accumulated depreciation		
At 1 January 2015	53,900	315,840
Revaluation	(53,900)	
Charge for the year ((2,300,000 – 600,000)/40) (W4)	42,500	103,177
Classified as held for sale ((20,000 – 10,240) + 1,840) (W2)		(11,600)
Impairment loss (W2)		1,840
	42,500	409,257
Carrying amount		
At 31 December 2015	2,257,500	613,093
At 31 December 2014	1,793,600	473,760

Workings

(1) Allocation of expenses

	Cost of sales £	Admin expenses £	Other operating costs £
Per draft	1,057,300	587,600	245,500
Income tax refund			5,500
Preference dividend paid		(30,000)	
Loss on held for sale asset (W2)	1,840		
Depreciation charges (c)	103,177	42,500	
Forex difference (W3)	(5,300)	(5,300)	
	1,157,017	594,800	251,000

(2) Impairment loss on asset held for sale

	£
Carrying amount on classification as held for sale (20,000 x 80% x 80% x 80%)	10,240
Sale proceeds less costs to sell (9,000 – 600)	(8,400)
	1,840

(3) Forex difference

	£
Euro purchase should have been included at 106,000 x 0.85	90,100
Euro purchase included at 106,000 x 0.80	(84,800)
	5,300

(4) Depreciation charge on plant and equipment

	£
On additions (252,750 (c) x 20% x 2/12)	8,425
On b/f (473,760 x 20%)	94,752
	103,177

(5) Retained earnings

	£
Per draft	1,327,840
Change in profit for the year (507,800 – 369,383)	(138,417)
Transfer from revaluation surplus (W6)	23,750
At 31 December 2015	1,213,173

(6) Revaluation surplus

		£
Per draft		512,600
Revaluation in year (2,300,000 – 1,793,600)		506,400
Depreciation charge on buildings for current year (c)	42,500	
Depreciation charge on buildings based on HC (750,000/40)	(18,750)	
		(23,750)
At 31 December 2015		995,250

(7) Redeemable preference shares

	B/f	Interest expense (6.3%)	Interest paid (6%)	C/f
	£	£	£	£
31 December 2015	500,000	31,500	(30,000)	501,500

There were some excellent, beautifully presented answers to this question, but there were also some incomplete, very messy ones. Almost all candidates produced a statement of profit or loss and a statement of financial position although, as always, some presentation marks were lost for not putting in totals and/or using abbreviations. With regard to the statement of profit or loss a number of candidates did not include a sub-total for profit before tax and/or included the finance cost in the wrong place. In the statement of financial position the non-current asset held for sale was sometimes seen at the top or in the middle of current assets or included within non-current assets. A number of candidates also showed non-current liabilities after current liabilities.

However, the standard of the property, plant and equipment movement note was generally very poor. Many candidates wasted time producing detailed workings and then effectively reproducing the same information in the disclosure note. It was clear that the majority of candidates did not understand what the note should look like and sometimes it was hard to distinguish between what was a working and what was meant to be the note. Many lost marks by not showing the figures for the depreciation charge and additions to plant and equipment as single figures. It was also clear that very few candidates knew how to deal with the transfer of the non-current asset held for sale out of non-current assets and many also struggled with the revaluation with relatively few showing the necessary adjustments to both cost and accumulated depreciation. As always it was often hard to see an "audit trail" for the total depreciation figures used in this note and in the costs working and often the figure for additions in the note was different to that used to calculate the depreciation charge on those additions.

Fewer candidates than usual adopted the recommended “costs matrix” approach, and instead produced linear workings or bracketed workings on the face of their statement of profit or loss. As ever, a number of candidates (most commonly those who started a costs matrix showing the draft cost figures in brackets) lost marks for incorrect signage/direction of their adjustments. The most common error was to adjust cost of sales and administrative expenses in the same direction for the foreign currency gain – as if this was a reallocation of the gain. Given that the vast majority of candidates debited property, plant and equipment and trade and other payables then two credits were needed here to complete the double entries.

With regard to calculations, nearly all candidates correctly calculated the depreciation charge for buildings, the foreign currency gain and the carrying amount of the non-current asset held for sale. Many candidates also arrived at the correct figures for the impairment, the tax charge and tax liability and for the preference shares, with most then correctly including the preference shares as a non-current liability. However, a minority of candidates wasted time producing complicated workings for the preference shares, attempting to discount the future payments ie treating the preference shares as a compound financial instrument. Others arrived at the correct figure in a working but then took the par value of £500,000 or the balance as at the following year end to non-current liabilities. Sometimes attempts were made to split one of these figures between current and non-current liabilities. Others showed finance costs as the dividend paid on the preference shares instead of as the true interest expense, even where the latter figure had been calculated to arrive at the correct carrying amount for the preference shares.

An encouraging number of candidates also arrived at the correct figure for the reserves transfer, although a worrying few transferred the whole of the revaluation gain made during the current year from the revaluation surplus to retained earnings. Others incorrectly calculated the depreciation charge based on historic cost.

Other common errors included the following:

- Making the adjustment for the income tax refund in the wrong direction in the costs working. Other candidates set this off against the balance of cash and cash equivalents (or adjusted cash and cash equivalents by some other inappropriate figure).
- Miscalculating the depreciation charge for plant and equipment by using the wrong number of months for the additions.
- Failing to adjust the additions to plant and machinery for the translation error made, even where the foreign currency gain had been correctly calculated.
- Using the wrong number of years when calculating the carrying amount of the machine on classification as held for sale.
- Not adjusting the trade and other payables figure to reflect the foreign currency gain.
- Failing to back out the draft profit figure from retained earnings.
- In addition to backing out the dividend paid on the preference shares from administrative expenses, also adding in the true interest expense. Others deducted the amount paid from retained earnings.

Total possible marks	27
Maximum full marks	25

1.2 Relevance and faithful representation

Relevant financial information is that which is capable of making a difference to the decisions made by users. The figure for the valuation of land and buildings for Pisa Ltd is relevant to the users as it gives them additional information about what the assets of the company are actually worth.

Financial information is capable of making a difference to the decisions made by users if it has predictive value, confirmatory value, or both. For example, the revenue figure for Pisa Ltd can be used by users to predict future revenues, but can also be used to confirm predictions they made in previous years.

The relevance of financial information is also affected by its nature/and its materiality. Information is material if omitting it or misstating it could influence users' decisions. The asset held for sale, although a relatively small amount, may be an important figure for the users of Pisa Ltd as it tells them that the company is divesting itself of assets.

To be useful financial information must faithfully represent the phenomena that it purports to represent. A perfectly faithful representation should be complete, neutral and free from error. The cost of plant and equipment in Pisa Ltd, measured using the cost model is likely to be a faithful representation as it is based on transactions that took place at a point in time. In contrast, the accumulated depreciation figure may not be, as useful lives and depreciation rates are based on judgement.

Substance over form is also implied in faithful representation because faithful representation of a transaction is only possible if it is accounted for according to its substance and economic reality. Hence, the redeemable preference shares which Pisa Ltd issued should have been accounted for in accordance with their substance, as a long-term loan, as opposed to their legal form of equity.

The conflict between relevance and faithful representation can best be illustrated by considering the figures for Pisa Ltd's property, plant and equipment. Although the valuation figure for land and buildings is likely to be high in relevance it is low in faithful representation, as all valuations are subject to judgement. Conversely, the historic cost figure for plant and equipment is high in faithful representation (based as it is on fact) but is low in relevance, as it is largely an out-of-date figure.

As usual, the answers to the concepts question were disappointing. Most candidates gained some marks by picking up the key phrases from the open book text to explain the two concepts but many went no further than this. Others, seemingly unaware of the information in the open book text, wrote only that "faithful representation" meant that information was "faithfully represented" and that "relevance" meant that information was "relevant".

Those that went further frequently used the revaluation and the preference shares as their examples from the information in the question. However, a worrying number of candidates suggested that the use of a valuation figure illustrated "faithful representation" and that the use of historical cost illustrated "relevance", instead of the other way round. Many presented long, circular arguments in trying to explain the conflict between the two concepts, without ever really getting anywhere. Many wrote at length on the merits of the property, plant and equipment movement note, without picking up many, if any, marks.

Total possible marks	8½
Maximum full marks (max 3½ for OBT refs)	5

Question 2

Total Marks: 34

General Comments

Part 2.1 of this question required candidates to explain the IFRS financial reporting treatment of three issues given in the scenario. The issues covered borrowing costs, research and development expenditure and a change in an accounting policy. All relevant calculations were required, as well as journal entries. Part 2.2 required a calculation of distributable profits, with an explanation as to where the finance director had made errors in his own calculation of this figure. Part 2.3 required a discussion of the ethical issues arising from the scenario and the action to be taken. Part 2.4 required candidates to describe any differences between IFRS and UK GAAP in respect of borrowing costs and development costs.

Naples plc

2.1 IFRS financial reporting treatment

(1) Borrowing costs

In accordance with IAS 23, Borrowing Costs, directly attributable borrowing costs relating to qualifying assets should be capitalised during the qualifying period. If the construction is financed out of general borrowings the amount to be capitalised should be calculated by reference to the weighted average cost of the general borrowings. In this case the weighted average cost of the loans is
5.2% (((£500,000 x 6%) + (£800,000 x 4.7%))/1,300,000).

Capitalisation should commence when the entity incurs expenditure for the asset (1 February 2015), incurs borrowing costs (1 January 2015) and undertakes activities that are necessary to prepare the asset for its intended use (1 January 2015) so from 1 February 2015. Capitalisation should cease when the asset is ready for use, so borrowings should only have been capitalised for nine months.

Luigi capitalised borrowing costs of £67,600 ((£500,000 x 6%) + (£800,000 x 4.7%)). This figure needs to be deducted from the 650,000 before the borrowing costs to be capitalised are calculated. Therefore only £22,714 ((650,000 – 67,600)) x 5.2% x 9/12) of the borrowing costs should have been capitalised The remaining interest of £44,886 (67,600 – 22,714) should be included in the statement of profit or loss as a finance cost.

To correct this the journal entries should be:

		£	£
Dr	Finance costs	44,886	
	Cr Property, plant and equipment – cost		44,886

Depreciation should have been charged from when the building was ready for use ie from 31 October 2015. The charge for the year should therefore have been £2,017 (650,000 – 44,886)/50 x 2/12). The journal entries should have been:

		£	£
Dr	Depreciation charge	2,017	
	Cr Property, plant and equipment – accumulated depreciation		2,017

The carrying amount of property, plant and equipment at 31 December 2015 will therefore reduce by £46,903 (44,886 + 2,017)/the asset in the course of construction will be
£603,097 (650,000 – 44,886 – 2,017).

(2) Research and development expenditure

In accordance with IAS 38, Intangible Assets, all expenditure that arises in the research phase should be recognised as an expense when incurred because there is insufficient certainty that the expenditure will generate future economic benefit. Development costs must be capitalised only once the IAS 38 criteria are met.

Therefore the costs of £55,500 incurred before the project was assessed as being commercially viable should not have been capitalised. The marketing costs should not have been capitalised because they cannot be directly attributed to producing or preparing the asset for its intended use. The cost of the intangible asset should therefore be reduced by £165,500 (390,500 – 225,000), leaving a carrying amount of £225,000.

To correct this the journal entries should be:

		£	£
Dr	Profit or loss account	165,500	
	Cr Intangible assets – cost		165,500

An intangible asset with a finite useful life, as here, should be amortised over its expected useful life. Luigi should therefore have charged amortisation for four months of the current year, over an expected three-year useful life, a charge of £25,000 (225,000 x 4/36). The journal entries should have been:

		£	£
Dr	Amortisation charge	25,000	
	Cr Intangible assets – accumulated amortisation		25,000

The carrying amount of intangible assets at 31 December 2015 will therefore reduce by £190,500 (165,500 + 25,000)/will be £200,000 (225,000 – 25,000).

(3) Change of accounting policy

IAS 8, Accounting Policies, Changes in Accounting Estimates and Errors, only allows a change in an accounting policy if:

- it is required by an IFRS; or
- it will result in the financial statements providing reliable and more relevant information.

This scenario would appear to meet the latter condition by “better matching purchases made to sales”. It is essentially a change in a recognition policy.

However, a change in an accounting policy should be applied retrospectively, ie as if the new policy had always applied. This means that Luigi should also have recognised the stores as inventory at 31 December 2014 and all previous years.

Where it is impracticable to determine the cumulative effect, as at the beginning of the current accounting period, of applying a new accounting policy to all prior periods, an entity should adjust the comparative information to apply the new policy from the earliest practical date. Therefore Luigi should have adjusted the 2014 comparatives to include closing inventories of consumable stores of £31,200. The impact of this on the 2015 financial statements will be to include opening inventories of consumable stores of £31,200, with a corresponding adjustment to retained earnings brought forwards (which will be shown in the statement of changes in equity).

The journal entries to achieve this are:

		£	£
Dr	Cost of sales	31,200	
	Cr Retained earnings		31,200

This will have the effect of reducing profit for the year by £31,200, with a corresponding increase to the profit for the previous year.

Candidates generally made a reasonable attempt at this question scoring all of the easier marks to gain a solid pass. Most answers were a good mixture of explanations and calculations, as opposed to answers to this question type in some earlier sessions, which focused on calculations at the expense of explanations. Almost all candidates attempted all three of the issues in this part, with the occasional missing answer to Issue (3). A minority of candidates failed to provide the required journal entries.

Issue (1): Most candidates made a good attempt at answering this issue, correctly identifying that the loans were not taken out specifically for this project and that a weighted average cost of general borrowings should be calculated. The majority of candidates who correctly identified that a weighted average calculation was necessary also correctly calculated the percentage to be used. However, candidates did not always state that it was directly attributable borrowing costs which should be capitalised and a significant number of candidates discussed whether the asset was a qualifying asset even though this had been stated in the question. A very significant number of candidates said that Naples plc “can” or “may” capitalise borrowing costs, rather than saying that they “should” or “must” (even where they then went on in 2.4 to say that under IFRS borrowing costs should be capitalised).

Almost all candidates correctly identified the date from which the borrowing costs should be capitalised and almost as many correctly identified the appropriate date on which capitalisation should cease, along with the correct explanation. Most candidates correctly calculated the figure which had incorrectly been capitalised during the year, although less went on to back this out of the cost of the building before calculating the amount of interest which should have been capitalised. The other common error here was to base the interest on the two loan values rather than on the expenditure incurred. A minority of candidates either didn’t pro-rate the interest or did so by an incorrect number of months.

The majority of candidates identified that depreciation needed to be recognised, even where they had incorrectly stated that borrowing costs should not be capitalised (usually on the grounds of these being general loans). The most common errors here were not adjusting the cost of the building by the appropriate (own figure) interest adjustments, based on the earlier part of their answer, or calculating depreciation for the incorrect number of months. A majority of candidates went on to provide a carrying amount for the office building at the year end, although often there was no working to accompany this (own) figure which meant that it gained no marks.

As stated above, a number of candidates failed to provide journal entries. Of those candidates who did, the journal for the depreciation adjustment was generally correct, but the journal for the borrowing costs was often confused. Candidates would write out what the journals should have been and then what was done, but their final journal setting out the correction was sometimes not clearly linked to the previous two steps. The most common error was, once again, not showing an “audit trail” for the net adjustment that needed to be made, which again led to a loss of marks.

Issue (2): This issue was also dealt with quite well although candidates did generally lose some marks here for a lack of explanation. Most candidates correctly identified that both the research and marketing costs should be expensed, although as stated above this was not always explained. A general discussion on when development costs should be identified was provided by most candidates although it often lacked any conclusion relating back to the scenario. Most candidates went on to calculate amortisation although less went on to finalise with a carrying amount for the intangible asset. Where journal entries were given, they were almost always correct. However, some candidates combined two sets of journals (the first writing off the expenditure which was not to be capitalised and the second putting through the amortisation charge) without showing how any net figures had been calculated.

Issue (3): This issue was less well answered. A few candidates missed the point entirely and simply discussed IAS 2, Inventories, and how inventory should be valued. However, a pleasing number of candidates did identify that this was a change in accounting policy, and that it should therefore be adjusted for retrospectively. Only a minority thought that it was a change in accounting estimate. It was good to see that a significant number of candidates correctly discussed the issue about whether the new policy presented reliable and more relevant information.

Adjustments which were then explained were generally quite confusing to read with candidates mixing the current and previous years up on a regular basis. Again, it was pleasing to see that a significant number of candidates identified and discussed the “impracticality” issue, although a few candidates simply stated that the prospective approach should be adopted as a result. Where journal entries were presented there was a mix between candidates either debiting or crediting retained earnings, although this was probably led by the confusion over which year they were adjusting.

Total possible marks	30
Maximum full marks	22

2.2 Distributable profits

Distributable profits are defined as accumulated realised profits less accumulated realised losses. However, there is an additional restriction for public companies, that they may not make a distribution if this reduces their net assets below the total of called-up share capital and undistributable reserves.

Both the share premium account and the revaluation surplus are unrealised reserves and may not be distributed.

The only reserve of Naples plc that could have been distributed is retained earnings.

Distributable profits should therefore have been calculated as:

		£
Original retained earnings		101,300
Less:	Finance costs (1)	(44,886)
	Depreciation (1)	(2,017)
	R&D expenditure (2)	(165,500)
	Amortisation (2)	(25,000)
Retained loss		(136,103)

Therefore Naples plc cannot pay a dividend for the year ended 31 December 2015 and could potentially be trading illegally.

Generally, candidates made a reasonable attempt at this part. This was encouraging as historically candidates have not performed well on this topic. Almost all candidates identified that the revaluation surplus and the share premium account should not have been included in the calculation of distributable profits, although a significant minority believed that the share premium account could be distributed.

Most candidates also made correct (own figure) adjustments for the issues from 2.1, although almost all candidates also adjusted for the retrospective adjustment for the change in accounting policy, failing to recognise that this had a zero impact on total retained earnings. A few candidates lost marks by netting off some of their adjustments made in 2.1 without providing supporting workings for these figures. Once again, without an appropriate “audit trail” marks will be lost.

Almost all candidates correctly concluded that a dividend should not have been paid as there were negative retained earnings. A significant number of candidates gained full marks on this part.

Total possible marks	6½
Maximum full marks	4

2.3 Ethical issues

Luigi appears to have a self-interest threat, as he is due a bonus based on the profit for the year. He also is due a dividend through his holding of ordinary shares, and the higher the profit for the year, the higher that dividend is likely to be. The "errors" which Roberto has discovered in the draft financial statements could be genuine mistakes due to a lack of knowledge, or could be a deliberate attempt by Luigi to overstate the profit for the year in order to increase his bonus and dividend. It may be that had it not been for Luigi's illness these "errors" would not have been discovered. The basic "errors" made by Luigi in his calculation of distributable profits also add weight to the theory that the errors may have been deliberate.

There are potential intimidation and self-interest threats for Roberto from Luigi or the other directors, as he may be under pressure to not make the adjustments to keep the profits high for the directors' bonus, and may be afraid he might lose his job.

As an ICAEW Chartered Accountant Luigi has a duty of professional competence and due care and should be aware of the correct IFRS financial reporting treatment for all of these issues, none of which are at all controversial.

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

- Explain to Luigi how each of these matters should be accounted for.
- If they appear to be genuine errors suggest that Luigi goes on an update course.
- If Luigi refuses to correct the errors, discuss the matters with the other directors to explain the situation and obtain support. Consider also discussing the issues with the external auditors/internal auditors/audit committee.
- Obtain advice from the ICAEW helpline or local members responsible for ethics.
- Keep a written record of all discussions, who else was involved and the decisions made.

There were some very high marks on this part and some excellent answers. Almost all candidates correctly identified the self-interest threat from the directors' bonus and a majority also identified the shares purchased by Luigi as a further self-interest threat. Most candidates recognised that the errors made in the draft financial statements were not those that an ICAEW Chartered Accountant should be making and hence, if these errors were indeed errors (as opposed to the deliberate manipulation of the financial statements), represented a breach of Luigi's duty of professional competence and due care.

A smaller number of candidates identified possible intimidation and/or self-interest threats for Roberto, in correcting financial statements prepared by his superior. However, some felt that the intimidation threat came from the managing director, which was unlikely given that he had "become increasingly concerned about Luigi's treatment of certain matters". Candidates need to take care to read the scenario carefully and not read into it factors that are not present. Most candidates made a very good attempt at listing the steps that Roberto should take to address the issues, picking up a good number of marks.

Fewer candidates than usual put their answer in an audit context, such as referring to reporting Luigi to the ethics partner or reviewing his work. However, a good number of candidates wasted time suggesting that Luigi should be made to sell his shares and/or suggesting alternative structures for a bonus scheme which avoided a link to profits.

Total possible marks	10
Maximum full marks	5

2.4 Differences between IFRS and UK GAAP: borrowing costs and development costs

UK GAAP	IFRS
Borrowing costs	
Under FRS 102 entities are allowed the choice of whether to capitalise borrowing costs or to recognise them as an expense when incurred.	IAS 23 gives no such choice. Capitalisation is required.
The borrowing costs calculation is based on the average carrying amount of the expenditure.	
Development costs	
Under FRS 102 an entity can chose whether or not to capitalise development costs.	IAS 38 requires all eligible development costs to be capitalised.
All intangible assets should be amortised, with the rebuttable presumption that the useful life this should not exceed five years.	Intangible assets need not be amortised and should be reviewed for impairment.

A few candidates did not attempt this part of the question. Those who did generally correctly identified the basic treatment for both borrowing and development costs under both IFRS and UK GAAP, although a minority said that development costs could not be capitalised under UK GAAP. A few candidates mixed up the treatment even where they had used the correct IFRS treatment in 2.1. A significant number of candidates who had said that borrowing costs “can” be capitalised in 2.1 correctly identified here that such costs “must” or “should” be capitalised. Some candidates went on to achieve full marks by discussing the amortisation of development costs.

Total possible marks	4½
Maximum full marks	3

Question 3

Total Marks: 18

General comments

Part 3.1 of this question tested the calculation of profit from discontinued operations, requiring an explanation of the calculation as well as the calculation itself. Part 3.2 required the preparation of a consolidated statement of cash flows and supporting note, incorporating the subsidiary disposed of during the year, in respect of which the calculation in Part 3.1 had been required. Missing figures to be calculated included dividends paid (to the group and to the non-controlling interest), finance lease liabilities paid, tax paid, additions to property, plant and equipment, and proceeds from the issue of share capital.

Genoa plc

3.1 Profit from discontinued operations

The profit from discontinued operations is comprised of two elements:

- the profit on disposal of the shares in Venice Ltd, and
- the results of Venice Ltd up to the date of disposal (ie for three months).

The profit on disposal should be calculated by comparing the sale proceeds to the net assets and goodwill at the date of disposal net of the non-controlling interest (NCI). The net assets at the date of disposal will be the net assets brought forward/on 1 January 2015, plus the profit earned by Venice Ltd to the date of disposal/three months pro-rated/1 April 2015.

		£	£
Sale proceeds			1,200,000
Less:	Carrying amount of goodwill at date of disposal:		
	Consideration transferred at date of acquisition	820,000	
	Net assets at date of acquisition (100,000 + 271,000)	(371,000)	
	NCI at date of acquisition (371,000 x 30%)	111,300	
	Goodwill at date of acquisition	560,300	
	Less: Impairment	(70,000)	
	Goodwill at date of disposal		(490,300)
	Net assets on 1 April 2015		(881,000)
Add:	NCI in net assets at date of disposal (881,000 x 30%)		264,300
Profit on disposal			93,000
Profit for the period (3/12 x (110,000 – 20,000))			22,500
Profit from discontinued operations			115,500

As this was a relatively straightforward calculation of a profit on discontinued operations it was disappointing not to see the correct figure more frequently. Most candidates made a reasonable attempt at calculating goodwill at disposal, although common errors were not including share capital in net assets and/or failing to deduct the impairment. Those who dealt with the impairment as a separate line rather than as part of the goodwill calculation often adjusted for it in the wrong direction. Surprisingly, a number of candidates used the wrong figure for net assets at disposal even though this was given in the question. By far the most common error related to the profit for the year up to disposal with most candidates taking only the parent's share and/or failing to deduct tax.

Some candidates made no attempt to explain how the figure should be calculated and those that did often discussed how it should be presented rather than calculated. This omission limited the number of marks which could be achieved on this part.

Total possible marks	7
Maximum full marks	5

3.2 Consolidated statement of cash flows for the year ended 31 December 2015

	£	£
Cash flows from operating activities		
Cash generated from operations (Note)	1,730,800	
Interest paid	(61,600)	
Income tax paid (W2)	(411,600)	
Net cash from operating activities		1,257,600
Cash flows from investing activities		
Purchase of property, plant and equipment (W3)	(1,894,100)	
Disposal of Venice Ltd net of cash disposed of (1,200,000 – 16,500)	1,183,500	
Net cash used in investing activities		(710,600)
Cash flows from financing activities		
Proceeds from share issues (W4)	192,000	
Repayment of finance lease liabilities (W1)	(501,400)	
Dividends paid (W5)	(92,500)	
Dividends paid to non-controlling interest (W6)	(87,500)	
Net cash used in financing activities		(489,400)
Net increase in cash and cash equivalents		57,600
Cash and cash equivalents at beginning of period		64,200
Cash and cash equivalents at end of period		121,800

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

	£
Profit before tax (1,938,900 – 93,000 (3.1))	1,845,900
Finance cost	61,600
Depreciation charge	673,800
Increase in inventories (2,143,100 – 1,230,100)	(913,000)
Increase in trade and other receivables ((870,200 + 69,500) – 839,800)	(99,900)
Increase in trade and other payables ((699,000 + 51,200) – 587,800)	162,400
Cash generated from operations	1,730,800

Workings

(1) Finance lease liabilities

	£		£
Cash (β)	501,400	B/d (324,000 + 177,800)	501,800
C/d (420,200 + 180,200)	600,400	Non-current assets	600,000
	1,101,800		1,101,800

(2) Income tax

	£		£
Cash (β)	411,600	B/d	453,600
C/d	504,000	CPL	462,000
	915,600		915,600

(3) Non-current assets

	£		£
B/d	2,973,600	Disposal of sub – PPE	846,200
		Depreciation charge	673,800
Finance leases	600,000	Disposal of sub – GW (3.1)	490,300
Additions (β)	1,894,100	C/d	3,457,400
	5,467,700		5,467,700

(4) Share capital and premium

	£		£
		B/d (480,000 + 48,000)	528,000
C/d (600,000 + 120,000)	720,000	Cash received (β)	192,000
	720,000		720,000

(5) Retained earnings

	£		£
Cash (β)	92,500	B/d	2,145,400
C/d	3,271,200	CPL	1,218,300
	3,636,700		3,363,700

(6) Non-controlling interest

	£		£
Cash (β)	87,500	B/d	891,100
Disposal of sub (3.1)	264,300		
C/d	797,900	CPL	258,600
	1,149,700		1,149,700

Answers to this part were very mixed with a minority of candidates barely attempting this part. Most candidates who made a decent attempt at this question did produce a reconciliation note although very few deducted the profit on disposal from Part 3.1 from the opening figure of profit before tax. Others simply deducted the £110,000 profit given in the question rather than the adjusted figure calculated in 3.1 or included the profit for the period as well as the profit on disposal. Most did add back the finance cost and depreciation charge and attempted to calculate the relevant adjustments to working capital, although a number failed to adjust these figures correctly (or at all) for the impact of the disposal.

On the face of the actual statement of cash flows it was surprisingly rare to see the correct figures for tax and interest paid – both relatively straightforward calculations. However, nearly all candidates arrived at the correct figure for the net cash relating to the disposal of the subsidiary and many also calculated the correct figures for the proceeds of the share issue and the dividend paid by the parent. It was much rarer to see correct figures for the purchase of property, plant and equipment, the repayment of the finance lease and the dividends paid to the non-controlling interest.

As always, some candidates lost marks for not showing outflows of cash in brackets and/or including figures under the wrong heading. A number of candidates also included tax and interest paid in the reconciliation note rather than on the face of the cash flow statement. Some candidates also appear to believe that dividends are *received* from the non-controlling interest (clearly describing them as dividends received) as opposed to being paid to them.

A significant minority of candidates continue to produce columnar or linear workings, rather than using the T-account approach recommended in the learning materials. Presentation of the statement of cash flows was mixed, with a good number of candidates failing to provide a sub-total for each type of cash flow.

Other common errors included the following:

- Failing to include the assets acquired under finance leases and/or the goodwill disposed of with the subsidiary in 3.1 in the property, plant and equipment working.
- Failing to include the disposal of the subsidiary in the non-controlling interest working.
- Mixing up the finance cost and finance lease workings.
- Including the tax charge relating to the subsidiary in the tax working.
- Failing to include both the non-current and current liability balances in the finance lease working.
- Not showing the correct figures for opening and closing cash and cash equivalents (or missing these out altogether). The most common error here was adjusting one of these figures for the cash disposed of with the subsidiary.

Total possible marks	13½
Maximum full marks	13

Question 4

Total Marks: 18

General comments

Part 4.1 of this question required the preparation of a consolidated statement of financial position for a group with one subsidiary, and a joint venture which was set up during the current year. The question also featured inter-company transactions and balances and fair value adjustments on acquisition. Part 4.2 tested the differences between IFRS and UK GAAP in respect of the financial reporting treatment and disclosures of joint ventures.

Rome plc

4.1 Consolidated statement of financial position as at 31 December 2015

	£	£
Assets		
Non-current assets		
Property, plant and equipment (W6)		6,074,600
Goodwill (W2)		73,500
Investment in joint venture (W4)		131,400
		6,279,500
Current assets		
Inventories (879,300 + 453,700 – 10,000 (W8))	1,323,000	
Trade and other receivables (641,500 + 392,300 – 100,000)	933,800	
Cash and cash equivalents (21,800 + 17,600 + 25,000)	64,400	
		2,321,200
Total assets		8,600,700
Equity and liabilities		
Equity		
Ordinary share capital		3,000,000
Retained earnings		3,639,140
Attributable to the equity holders of Rome plc		6,639,140
Non-controlling interest (W3)		683,560
		7,322,700
Current liabilities		
Trade and other payables (547,200 + 380,800 – 75,000)	853,000	
Taxation (250,000 + 175,000)	425,000	
		1,278,000
Total equity and liabilities		8,600,700

Workings

(1) Net assets – Turin Ltd

	Year end £	**Acq** £	**Post acq** £
Share capital	800,000	800,000	
Retained earnings	2,422,300	856,500	
Less: PURP (W8)	(10,000)		
Fair value adjs			
Goodwill		(40,000)	(50,000)
Property	300,000	300,000	
Deprec on property (300,000/25 years x 4)	(48,000)		
	3,424,300	1,906,500	1,517,800

(2) Goodwill – Turin Ltd

	£
Consideration	1,600,000
Non-controlling interest at acquisition at fair value	380,000
Less: Net assets at acquisition (W1)	(1,906,500)
	73,500

(3) Non-controlling interest – Turin Ltd

	£
Fair value at acquisition	380,000
Share of post-acquisition reserves (1,517,800 (W1) x 20%)	303,560
	683,560

(4) Investment in joint venture – Florence Ltd

	£
Cost (100,000 x £1)	100,000
Share of post-acquisition retained earnings (125,600 x 25%)	31,400
	131,400

(5) Retained earnings

	£
Rome plc	2,403,900
Turin Ltd (1,517,800 (W1) x 80%)	1,214,240
Florence Ltd (W4)	31,400
Less: PPE PURP (W7)	(10,400)
	3,639,140

(6) Property, plant and equipment

	£
Rome plc	2,958,500
Turin Ltd	2,874,500
Fair value adjustment (300,000 – 48,000) (W1)	252,000
Less: PPE PURP (W7)	(10,400)
	6,074,600

(7) PPE PURP

	£
Asset now in Turin Ltd's books at 35,000 x 4/5 years	28,000
Asset would have been in Rome plc's books at 22,000 x 4/5 years	(17,600)
	10,400

(8) PURP

	%	£
Selling price	125	100,000
Cost	(100)	(80,000)
GP	25	20,000
X ½		10,000

Almost all candidates made a good attempt at this part, with presentation of the statement of financial position often being better than on Question 1. Candidates had obviously practised this question style at length and as a result gained a significant number of marks; it was not uncommon for candidates to gain full marks. However, once again, a number of candidates lost marks where they failed to provide an "audit trail" through their answer.

The most common areas where no audit trail was shown were for figures on the face of the consolidated statement of financial position, eg inventories, trade and other receivables, cash and cash equivalents etc and also for the calculation of the non-controlling interest and retained earnings for the percentage of the subsidiary's figure for post-acquisition profits. It is not sufficient to show the percentage and then reference to another (the net assets) working; unless both a percentage and a figure from another working are shown, no marks will be awarded if the calculation contains an error.

However, candidates' answers were well laid out and generally candidates did make adjustments to figures on the face of the consolidated statement of financial position. The most common errors centred on the cash in transit. Many included no adjustment for trade and other payables (or incorrectly used £25,000) and/or no adjustment for trade and other receivables (or incorrectly used £75,000). Cash and cash equivalents was more often adjusted, and usually by the correct figure. Most candidates presented a net assets table in the format used in the learning materials, and went on to complete the standard workings. This approach maximises the marks candidates can achieve and that was seen in this particular question.

In the net assets table candidates often used the wrong number of years for the depreciation adjustment and also it was also fairly common for candidates to add rather than deduct the adjustment in respect of the goodwill which had arisen on the acquisition of a sole trader. Only a minority of candidates missed that they should use fair value method for the non-controlling interest in the goodwill and non-controlling interest calculations. Most candidates correctly calculated the inventory provision for unrealised profit, although slightly less managed to correctly calculate the property, plant and equipment provision for unrealised profit. The most common error in the joint venture calculation was to pro-rate the profit figure, even though it clearly stated in the question that this was for the nine month period.

Total possible marks	17½
Maximum full marks	16

4.2 Differences between IFRS and UK GAAP: joint ventures

UK GAAP	**IFRS**
FRS 102 recognises implicit goodwill on acquisition of a joint venture and requires it to be amortised.	Under IAS 28, goodwill is subsumed within the investment in joint venture figure.
FRS 102 does not require such detailed information about the investee or about risks associated with the investment.	IFRS 12 specifies disclosure requirements for interests in joint ventures.

Candidates clearly struggled with the UK GAAP differences in relation to joint ventures. This was the most poorly answered part of the whole paper, with candidates who did attempt this part consistently scoring no marks. The majority of candidates included reference to one or more differences in the preparation of group financial statements, which had no relevance to the differences in relation to joint ventures. Answers included discussions around the use of the equity method for IFRS only and the presentation of a separate column for UK GAAP (as opposed to a separate line for IFRS). Others said that a joint venture under UK GAAP was treated as an intangible asset. Only a small minority of candidates identified any relevant points here, although full marks were still seen by a very small number of candidates.

Total possible marks	3
Maximum full marks	2