MARK PLAN AND EXAMINER'S COMMENTARY

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

Question 1

Total marks: 30

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

General comments
This question presented a draft set of financial statements with some adjustments. Candidates were required to prepare the amended statement of profit or loss and statement of financial position. A number of adjustments were required to be made, including depreciation, revenue adjustments, provisions, treasury shares, a lease incentive and a prior year inventory adjustment.
Part b) required candidates to explain the concepts of accruals basis of accounting and going concern, with reference to the scenario.
Part c) required a discussion on the ethical issues arising from the scenario.

Coghlan Ltd – Statement of financial position as at 30 September 2014

	£	£
ASSETS		
Non-current assets		
Property, plant and equipment (600,000 + 138,260) (W3)		738,260
Current assets		
Inventories	98,000	
Trade and other receivables	125,400	
Tax asset	65,000	
Cash and cash equivalents	1,200	
		289,600
Total assets		1,027,860
Equity		
Ordinary share capital (294,500 + 85,500)	380,000	
Share premium	94,000	
Treasury shares (45,000 x £1.90)	(85,500)	
Retained earnings (W4)	52,910	
Equity		441,410
Non-current liabilities		
Lease incentive		7,200
Current liabilities		
Trade and other payables	31,900	
Deferred income (36,000 x 3/12)	9,000	
Provision (W2)	538,350	
		579,250
Total equity and liabilities		1,027,860

Coghlan Ltd – Statement of profit or loss for the year ended 30 September 2014

	£
Revenue (3,359,200 – (36,000 x 3/12))	3,350,200
Cost of sales (W1)	(2,744,950)
Gross profit	605,250
Administrative expenses (W1)	(1,418,965)
Loss before tax	(813,715)
Income taxation (65,000 + 32,800)	97,800
Net profit for the period	(715,915)

W1 Expenses

	Cost of sales £	Administrative expenses £
Brought forward	2,198,050	1,039,700
Opening inventories adj (114,550 – 79,000)	(35,550)	
Closing inventories adj (142,100 – 98,000)	44,100	
Provision (W2)	538,350	
Lease incentive (1,200 x 6)		7,200
Impairment (W3)		293,750
Depreciation charge (43,750 + 34,565) (W3)		78,315
	2,744,950	1,418,965

W2 Provision

		£
Brought forward		500,000
Lawsuits (50 x 350)	17,500	
Warranties ((65,000 x 20%) + (157,000 x 5%))	20,850	
At 30 September 2014		38,350
		538,350

W3 Plant and equipment

	Land and buildings £	Fixtures and fittings £
Carrying amount at 1 Oct 2013 (1,125,000 – 187,500) / (236,000 – 63,175)	937,500	172,825
Depreciation charge for the year		
(1,125,000 – 250,000) x 5%	(43,750)	
172,825 x 20%		(34,565)
Carrying amount at 30 Sept 2014	893,750	138,260
Recoverable amount	600,000	170,000
Impairment	293,750	–

W4 Retained earnings

	£
Per draft	425,825
Add: draft loss	416,550
Less: revised profit and loss	(715,915)
Dividend paid (380,000 x 10p)	(38,000)
Prior year adjustment – inventories	(35,550)
	52,910

Presentation of the statement of profit or loss and statement of financial position was generally good. As indicated as acceptable at the tutor conference, most candidates omitted sub-totals on the statement of financial position, but were penalised if they omitted totals for total assets and total equity and liabilities. A minority missed out sub-totals on the statement of profit or loss – this is not considered acceptable and marks were lost for this. However, there were a number of very messy statements, usually the statement of profit or loss, where costs workings were shown on the face of the statement instead of in a recommended "costs

matrix" in the workings. Whereas in most recent sittings almost all candidates have used a costs matrix, this was not the case at this sitting.

Performance on this question was good, with some high marks achieved. A significant number of candidates arrived at completely correct figures in respect of revenue, cost of sales, closing inventories and the provision. Most candidates also arrived at the correct figures for the two depreciation charges for the year, and correctly presented them in administrative expenses. However, a few candidates calculated depreciation based on the year end recoverable amounts instead of on the opening figures. It was also common to see the fixtures and fittings, which were not impaired, revalued, when no indication was given that the company wished to move to the revaluation model. Pleasingly, most candidates did provide relatively clear workings for their property, plant and equipment figure.

The tax refund probably caused the most difficulties, with only a few candidates treating both this and the over-provision from the previous year correctly. A number of candidates showed only the tax refund in the statement of profit or loss, others reduced the tax refund by the over-provision from the previous year, instead of adding it. Many were so confused by the income tax position that they showed no figure for income tax at all in the statement of profit or loss. On the statement of financial position it was common to see the over-provision from the previous year reducing the tax asset. And whatever figure was arrived at this was presented more often as a "negative" current liability than (correctly) as a current asset.

Other common errors included the following:

- Errors in adjusting cost of sales for the incorrect inventory valuations – most commonly getting the net adjustment in the wrong direction against the cost of sales figure from the draft financial statements, or making careless errors in the calculations.
- Calculating the dividend paid during the year on a figure other than the one shown in their own statement of financial position.

Total possible marks Maximum full marks	20½ 19

(b)

Accrual basis

The accrual basis of accounting records transactions in the period in which they occur, rather than when the cash inflow or outflow arises. Under the accrual basis an entity recognises items as assets, liabilities, equity, income and expenses when they satisfy the definition and recognition criteria for those elements in the Framework

An example of this is the treatment of the revenue generated from the magazine subscriptions. These were incorrectly recorded in revenue as the cash had been received, however part of the service delivery, ie the magazines being despatched, arose after the year end and therefore part of the revenue should have been deferred.

The recognition of the provisions are another example of the accrual basis, as these are present obligations arising from past events and hence have been recognised as liabilities in the current period, although the cash will be paid out in future periods.

Other examples include the charging of depreciation on the property, plant and equipment recognising that the entity is generating economic benefits from these assets over their useful lives and the charging of operating lease rental over the total period of the lease.

Going concern basis

The going concern basis of accounting assumes that the entity will continue operating in the foreseeable future as a going concern. To operate for the foreseeable future there must be no intention by management, or the need, to liquidate the entity by selling its assets and paying its liabilities.

The going concern basis affects the valuation of the company's assets. It is assumed that non-current assets, for example, will be used in the operation of the entity and therefore the use of historical cost is considered appropriate. However, if the entity ceases in operation then the historical cost basis would no longer be

appropriate and instead the assets would be valued based on their recoverable amount at that point in time, this valuation basis is known as the break-up basis. The concept of being “non-current” also would no longer be appropriate as all assets and liabilities would be “current” in nature as the entity would no longer be trading.

Coghlan Ltd’s financial statements have been prepared using the going concern basis of accounting. If the break-up basis were appropriate due to the company no longer being a going concern, as a result of the adverse publicity, caused by the unsafe products, assets and liabilities might be different. For example, Coghlan Ltd has five years left on the office lease, if Coghlan Ltd ceased to trade the lease would become an onerous obligation and the full amount would need to be recognised.

Coghlan Ltd traded at a large loss during the year, if this performance continues it is unlikely that the company would be a viable trading entity for long. In addition a dividend was paid, presumably to ensure shareholders remained happy, however as a result of this retained earnings and hence distributable profits are virtually zero, so no further dividends could be paid in the future without substantial profits being made. It is therefore questionable whether Coghlan Ltd will remain a going concern for much longer.

This part of the question was reasonably well answered although few candidates scored high marks. Most candidates could give a basic definition of the accruals concept, but the quality of explanation using the subscription revenue and the operating lease varied.

Again, most candidates could give a basic definition of the going concern concept, and cite the break-up basis as an alternative, but less candidates went beyond this to explain how going concern financial statements differ from those prepared on a break-up basis. However, a majority of candidates made the point that Coghlan Ltd appeared to be in financial difficulties and that therefore the going concern basis may not be appropriate.

Total possible marks	11
Maximum full marks	6

(c)

Professional accountants are expected to follow the guidance contained in the fundamental principles in all of their professional and business activities. The Code of Ethics has five fundamental principles.

The financial statements should be prepared fairly, honestly and in accordance with relevant professional standards.

Objectivity is one of the five fundamental principles in the ICAEW’s ethical Code, which means that I should not allow bias, conflict of interest or undue influence of others to override professional or business judgements. I should not let the managing director pressure me into completing the financial statements quickly and not making a satisfactory and thorough job. Intimidation threat exists.

Professional behaviour is another principle and hence I should ensure that the relevant laws and regulations are complied with. I should ensure that I act with both professional competence and due care and therefore not be influenced by the pressure that management are putting on me. The financial statements should be prepared by someone who has the relevant expertise and that is unlikely to be someone who is undertaking work experience. I should not allow bias in any way, conflict of interest or undue influence of others override my professional judgement. It is unfair for the managing director to mention my performance appraisal and therefore I need to ensure that this does not affect any decisions I make as a self-interest threat exists.

I should explain that the financial statements need additional work to the managing director and explain that they may take longer than he would have ideally liked to ensure that they provide a fair assessment of the facts. If he is unwilling to allow additional time then I should discuss the matter with the other directors and explain that I am being pressured by the managing director. I should keep a record of all discussions and I could discuss the matter confidentially with the ICAEW helpline for advice and support.

The answers to the “ethics” part were mixed, with a significant number of candidates putting themselves in the position of being the external auditor, as opposed to the financial controller, as specified in the question. Most candidates identified self-interest and possible intimidation threats, that the financial controller should uphold the values of professional competence and due care and professional behaviour, and refer continuing difficulties with the managing director to the other directors and then to the ICAEW ethics helpline. Weaker candidates missed the point that all discussions should be documented and spent some time discussing the ethics of the managing director, when we were not told whether he was an ICAEW Chartered Accountant or not.	
Total possible marks Maximum Marks	8½ 5

Question 2

Total marks: 36

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

General comments
Part (a) of this question required candidates to explain the financial reporting treatment of four accounting issues, given in the scenario. The four issues covered borrowing costs, a compound financial instrument, an intangible asset and a joint venture. Journal entries were also required.
Part (b) required candidates to recalculate consolidated profit for the year for the adjustments needed as a result of their answer to Part (a).
Part (c) required a calculation of basic earnings per share following a rights issue and explanation of the accounting treatment was also required.

Porcaro plc

(a) (i) IFRS accounting treatment

(1) Borrowing cost

Under IAS 23 Borrowing costs, certain borrowing costs form part of the cost of the qualifying asset, and should therefore be capitalised. A qualifying asset is an asset which takes a substantial period of time to get ready for its intended use, or sale. The office block is therefore a qualifying asset as it is not ready for use.

Borrowing costs are defined as interest and other costs that an entity incurs in connection with the borrowing of funds. Only borrowing costs that are directly attributable to the acquisition, construction or production of the qualifying asset should be capitalised. These are the borrowing costs which would have been avoided if the expenditure on the qualifying asset had not been incurred.

As the loan was specifically taken out for the purpose of funding the construction of the office block use the actual interest rate of 6%.

Capitalisation of borrowing costs should commence when the entity meets all three of the following conditions:

(1) It incurs expenditure on the asset (the payment to acquire the land was made on 1 October 2013);
(2) It incurs borrowing costs (the loan was taken out on 1 October 2013, from which date interest will start to accrue);
(3) It undertakes activities that are necessary to prepare the asset for its intended use (the land was acquired on 1 October 2013 with planning permission which was needed for construction to take place).

Borrowing costs of £36,000 (600,000 x 6%) should therefore be capitalised from 1 October 2013.

Where the borrowed funds are not required immediately, so instead are put on deposit, the borrowing costs capitalised should be reduced by the investment income received on the invested funds.

Investment income: (600,000 – 200,000 = 400,000)

(1 Oct 2013 – 28 Feb 2014)	400,000 x 3% x 5/12 =	£5,000
(1 Mar – 31 Aug 2014)	300,000 x 3% x 6/12 =	£4,500
(1 Sept – 30 Sept 2014)	100,000 x 3% x 1/12 =	£250
		£9,750

Total borrowing costs which should be capitalised are £26,250 (36,000 – 9,750). No depreciation should be recognised on the office block as it's not ready for use.

The journal entries required are:

	£	£
DR: Property, plant and equipment (SOFP)	26,250	
CR: Net interest (PorL)		26,250

(2) Convertible bonds

The convertible bonds are compound financial instruments per IAS 32 Financial Instruments: Presentation. They have both an equity and a liability component which should be presented separately at the time of issue. IAS 32 requires that the substance of such an instrument be reflected, focusing on the economic reality that in effect two financial instruments have been issued.

The liability component should be measured first at the present value of the capital and interest payments. The discount rate used should be the effective rate for an instrument with the same terms and conditions except without the ability to convert it into shares.

	Cash flow £	**Discount factor @ 7%**	**Present value £**
1 October 2014	30,000	1/1.07	28,037
1 October 2015	30,000	$1/1.07^2$	26,203
1 October 2016	30,000	$1/1.07^3$	24,489
1 October 2017 (redemption)	630,000	$1/1.07^4$	480,624
Liability component			559,353
Equity component (bal fig)			40,647
Total			600,000

The liability should initially be measured at £559,353 and the equity component is the residual at £40,647. Once recognised the equity element remains unchanged. However, the liability element should be shown at amortised cost at the end of each year:

1 Oct 2013	Interest (7%)	Payment (5%)	30 Sept 2014
£	£	£	£
559,353	39,155	(30,000)	568,508

At the year an adjustment should be made to non-current liabilities of £31,492 (600,000 – 568,508), and an additional £9,155 recognised as finance costs as part of profit or loss.

The journal entries required are:

	£	£
DR: Non-current liabilities (SOFP)	31,492	
DR: Finance costs (PorL)	9,155	
CR: Equity (SOFP)		40,647

(3) Intangible asset – licence

The licence should be recognised as an intangible asset as it is an identifiable non-monetary asset without physical substance. The licence is identifiable as it arises from contractual or legal rights to use the microchip technology.

The licence should initially be recognised at its cost of £72,000. Amortisation of £6,000 ((72,000 / 6yrs) x 6/12) should be recognised as part of profit or loss. The carrying amount of the licence at 30 September 2014 under historical cost accounting is £66,000 (72,000 – £6,000).

The licence can continue to be held at cost or may be revalued if the directors can show that an active market exists for it. Although a competitor has offered to buy the licence which suggests that an active market exists, part of the definition also requires the items traded to be homogenous. As it states that the licence is unique it is unlikely that it will meet this definition and therefore should be held at historical cost.

The revaluation gain of £18,000 (£90,000 - £72,000) at 30 September 2014 should be reversed.

The journal entries required are:

	£	£
DR: Equity – Revaluation surplus (SOFP)	18,000	
DR: Amortisation (PorL)	6,000	
CR: Non-current assets (SOFP) (18,000 + 6,000)		24,000

(4) Joint venture

Porcaro plc should recognise its investment in Barbarossa Ltd as a joint venture. Four companies have joint control over Barbarossa Ltd and there is a contractual arrangement in place to share profits and losses equally.

IFRS 11 Joint Arrangements requires the use of the equity method for joint ventures. The investment should therefore be recognised at cost of £25,000 plus the share of the joint venture's post acquisition increase in net assets, £32,500 (£130,000 x 25%).

The investment in Barbarossa Ltd will be shown as a non-current asset, rather than a current asset in the consolidated statement of financial position, so the £25,000 will need to be reclassified. The share of post-acquisition profit of £32,500 should be added to non-current assets, giving a carrying amount of £57,500 and the £32,500 recognised in consolidated profit or loss.

The journal entries required are:

	£	£
DR: Non-current assets (SOFP)	57,500	
CR: Current assets (SOFP)		25,000
CR: Share of joint venture profit (PorL)		32,500

Most candidates produced reasonably detailed narrative explanations, melded together with calculations although less went on to produce journal entries. Only the very weakest candidates restricted their answers to predominantly calculations, with little explanation. Answers to Issues (1), (2) and (4) were all reasonably well attempted, with Issue (3) causing some difficulties.

Borrowing costs
Most candidates set out the appropriate terminology, such as "directly attributable" and "qualifying asset", and correctly concluded that the office block was a qualifying asset and that interest on the loan should be capitalised. However, a significant number of candidates were careless in their choice of words and stated that borrowing costs "could" be capitalised – implying a choice in the matter (even when in Part (d) they went on to clearly state that under IFRS borrowing costs must be capitalised). Most then listed the IAS 23 criteria for the commencement of capitalisation, but few applied these criteria to this scenario. Of those that did, many concluded, in error, that capitalisation could not commence until 31 December 2013, and hence only capitalised nine months of the annual interest.

Almost all candidates stated that the borrowing costs should be reduced by the investment income on surplus funds. Calculations for the investment income often contained errors generally around the number of months. The 6% actual interest rate was used, although only a very small minority explained why this was appropriate. Almost all candidates then set out the correct journal entry for their net figure.

Convertible bonds
The majority of candidates explained that this was a compound financial instrument and that split accounting was appropriate, with fewer mentioning substance over form. Most of these candidates then produced correct calculations for the split of debt and equity and for the amortised cost of the debt, although less referred to "amortised cost" in their explanation. Journal entries were largely correct, although some candidates took a rather convoluted approach to arriving at the correct net journal.

Intangible asset – licence
This issue caused the most problems. Most candidates gave some basic definitions and calculated the initial carrying amount of the intangible at cost (although some used the incorrect number of months for the amortisation charge). Answers were then mixed, depending on whether candidates realised that the information in the scenario did not support the existence of an "active market". Those that saw this quickly concluded their answer by reversing out the revaluation. The ones that did not then wasted time calculating

additional amortisation charges, and sometimes also transfers between the revaluation surplus and retained earnings. Others hedged their bets and set out both accounting treatments without a conclusion, which was time consuming.

Joint venture
There was a lot of confusion to this issue and candidates seem to struggle between the concept of an associate and a joint venture, with many candidates simply believing they are the same instrument. Although the majority of candidates identified that equity accounting should be applied and recognised the cost correctly, candidates often described the investment as an associate. Journal entries were usually correct, with the most common error being to credit cash instead of current assets. The only real error seen in the calculations was taking the appropriate share of only a fraction of the profit after tax, instead of the appropriate share of the whole figure, which was stated to be the profit for that period.

Total possible marks	36
Maximum full marks	27

(b)

Porcaro plc – Group figures

	Profit for the year £	£
As stated		483,150
Issue (1)	26,250	
Issue (2)	(9,155)	
Issue (3)	(6,000)	
Issue (4)	32,500	
Profit adjustment		43,595
		526,745

Most candidates appeared to adopt the recommended approach of setting up a schedule as the first page of their answer starting with the draft profit from the question, and adjusted this as they wrote their explanation for each issue. Many candidates did therefore score the full two marks for this part, based sometimes on completely correct and sometimes on their “own” figures. Only the very weakest candidates failed to attempt this part of the question. Where marks were lost it was generally where candidates failed to replicate in this part the journal entries set out in their answers to Part (a).

Total possible marks	2
Maximum full marks	2

(c)

Porcaro plc

	No. Of shares	Period in issue	Bonus factor	Weighted average
1 Oct 2013 – 31 Jan 2014	270,000	4/12	210/200	94,500
Rights issue 1 for 3	90,000			
1 Feb – 30 Sept 2014	360,000	8/12		240,000
				334,500

Theoretical ex-rights price:	£
3 shares @ £2.10	6.30
1 share @ £1.70	1.70
	8.00

Theoretical ex-rights price per share £8.00 / 4 = £2.00
Bonus fraction: 210 / 200

Basic EPS = $\frac{526,745}{334,500}$ = £1.57

A rights issue is an issue of shares to current shareholders in proportion to their existing holdings at a discount to market price. Because the share issue is below market price, a rights issue is in effect a combination of an issue at full market value and a bonus issue. An adjustment therefore needs to be made to the earnings per share for the bonus element. This is calculated by comparing the pre-rights market value with the theoretical ex-rights price. The theoretical price is the price at which the shares would have traded after the rights issue in theory.

A good number of candidates arrived at the correct weighted average number of shares, and produced an EPS based on that and their own figure for revised profit for the year. However calculations often contained errors in the theoretical ex-rights price per share. Only the very best candidates could explain clearly why the rights issue had been scaled up by a bonus fraction, and many of these candidates achieved full marks for this part of the question. Weaker candidates merely described in words what they had done in their calculation. A minority of candidates described the accounting entries for the rights issue which gained no marks.

Total possible marks	7½
Maximum full marks	6

(d) UK GAAP differences

Borrowing costs
Under UK GAAP Porcaro plc has the choice whether to capitalise borrowing costs. If a policy of capitalisation is chosen then this policy should be applied to the class of qualifying assets.

Under IFRS borrowing costs which meet the definition of being directly attributable to the acquisition, construction or production of a qualifying asset must be capitalised.

Most candidates achieved the full one mark for this part, clearly stating that capitalisation is mandatory under IFRS, but optional under UK GAAP. Only the weakest candidates got this the wrong way round, or failed to give both the IFRS and UK GAAP treatments.

Total possible marks	1½
Maximum full marks	1

Question 3

Total marks: 11

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

General comments
This question was a mixed topic question, covering the completion of extracts from the statement of cash flows for adjustments to investing and financing activities. Part b) required the preparation of an extract from the consolidated statement of financial position, showing non-current and current assets.

Henrit plc

(a)

Consolidated statement of cash flows (extract)

Cash flows from investing activities	**£**
Purchase of property, plant and equipment (W2)	(365,450)
Proceeds from sale of property, plant and equipment (124,000 + 9,500)	133,500
Cash flows from financing activities	
Payment of finance lease (15,000 – 7,375) (W3)	(7,625)
Proceeds from issue of loan (450,000 – 290,000)	160,000

Workings

(1) Interest

	£
290,000 x 5% x 6/12	7,250
450,000 x 5% x 6/12	11,250
	18,500

(2) PPE

	£		**£**
B/d	729,400	Disposals	124,000
Additions – finance lease (W3)	105,350	Depreciation	113,000
Additions – cash (β)	365,450	C/d	963,200
	1,200,200		1,200,200

(3) Finance lease

	£		**£**
Cash	15,000	B/d	–
		PPE addition (β)	105,350
C/d	97,725	Interest (25,875 – 18,500 (W1))	7,375
	112,725		112,725

Answers to this requirement were quite mixed, with a significant number of candidates achieving full marks. Most candidates successfully calculated the proceeds from the disposal of equipment and also attempted to produce a T-account for property, plant and equipment to identify the cost of additions. Within this working nearly all candidates correctly credited the depreciation charge for the year and the carrying amount of the equipment that had been sold. The majority of candidates also realised that they needed to debit the account with plant acquired under a finance lease but very few candidates calculated this figure correctly. Most simply used the closing balance on the finance lease account given in the question.

It was clear that the majority of candidates either do not understand that payments under finance leases need to be split between interest and capital or cannot calculate the split. Many candidates merged the finance lease liability and the bank loan and as a result lost the easy mark available for showing the inflow of cash relating to the bank loan. Some candidates used the information given in the question to calculate the interest relating to the bank loan but then made no use of this information.

With regards to presentation nearly all candidates did produce extracts as required and also entered figures under the appropriate headings, although totals were often not seen. As is always the case with questions on the statement of cash flows a significant number of candidates lost marks for failing to put brackets around outflows of cash.

Total possible marks	8½
Maximum full marks	6

(b)

Statement of financial position at 30 September 2014 (extract)

Non-current assets	
Property, plant and equipment (963,200 + 469,400 + 623,150 – 4,400 (W2))	2,051,350
Goodwill (73,400 + 17,750 (W1))	91,150
Current assets	
Inventory (46,980 + 18,900 + 31,300 – 1,500 (W3))	95,680

Workings

(1) Goodwill – Crago Ltd

	£
Consideration transferred (230,000 + (45,000 x 3.15))	371,750
Non-controlling interest at acquisition at fair value	261,000
Less: Net assets at acquisition	(615,000)
	17,750

(2) Inter-company machine transfer

	£
Original carrying amount (95,000 – (95,000 x 3/5))	38,000
Consideration less depreciation (53,000 – (53,000 x 6/30))	(42,400)
Unrealised profit	4,400

(3) PURP

	%	£
SP	115	11,500
Cost	(100)	(10,000)
GP	15	1,500

Generally this was well answered with many candidates achieving full marks. A majority of candidates correctly calculated goodwill and the PURP relating to inventory and made the relevant adjustments to the figures given in the question. A minority of candidates used the nominal rather than the market value of the shares to calculate the consideration for the acquisition of the subsidiary and a similar number calculated the PURP using gross margin rather than a mark-up on cost.

However only a small minority of candidates correctly calculated the PURP relating to the sale of the machine. Common errors were to calculate the profit on disposal or the difference in the subsequent depreciation and therefore only adjust for part of the difference.

As with part (a) nearly all candidates produced extracts but again a number failed to add numbers across so could not be given full credit for presentation.

Total possible marks	6
Maximum full marks	5

Question 4

Total marks: 23

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

This question required the preparation of a consolidated statement of profit or loss and extracts from the consolidated statement of changes in equity (for retained earnings). The group had two subsidiaries, one of which was disposed of during the year. A fair value adjustment was required on acquisition of one of the companies. Inter-company trading took place during the year between one of the subsidiary's and the parent.

Part (b) required candidates to describe the UK GAAP differences for the acquisition and disposal of a subsidiary.

Mantia plc

(i) Consolidated statement of profit or loss for the year ended 30 September 2014

	£
Continuing operations	
Revenue (W1)	3,722,000
Cost of sales (W1)	(1,658,500)
Gross profit	2,063,500
Operating expenses (W1)	(536,055)
Profit from operations (W1)	1,527,445
Investment income (W1)	17,000
Profit before tax	1,544,445
Income tax expense (W1)	(327,000)
Profit for the year from continuing operations	1,217,445
Discontinued operations	
Profit for the year from discontinued operations (300,100 (W2) – 32,715 (W4))	267,385
Profit for the period	1,484,830
Profit attributable to	
Owners of Mantia plc (β)	1,327,451
Non-controlling interest (W2)	157,379
	1,484,830

(ii) Consolidated statement of changes in equity for the year ended 30 September 2014 (extract)

	Retained earnings £
Balance at 1 October 2013 (W6)	227,249
Total comprehensive income for the year	1,327,451
Dividends (W6)	(600,000)
Balance at 30 September 2014 (β)	954,700

Workings

(1) Consolidation schedule

	Mantia plc £	Appice Ltd £	Adj £	Consol £
Revenue	2,986,000	768,000	(32,000)	3,722,000
Cost of sales – per Q	(1,343,700)	(345,600)	32,000	(1,658,500)
– PURP (W5)		(1,200)		
Op expenses – per Q	(419,575)	(84,480)		(536,055)
– FV deprec (70,000/10yrs)		(7,000)		
– Impairment of goodwill	(25,000)			
Investment income	42,600			
– Appice (80,000 x 40p x 80%)			(25,600)	17,000
Tax	(259,000)	(68,000)		(327,000)
		261,720		

(2) Non-controlling interest in year

	£
Appice Ltd (20% x 261,720 (W1))	52,344
Starkey Ltd (35% x 300,100 (600,200 x 6/12))	105,035
	157,379

(3) Goodwill – Starkey Ltd

		£
Consideration transferred		230,000
Non-controlling interest at acquisition (302,000 x 35%)		105,700
		335,700
Less: Net assets at acquisition		
Share capital (91,000 / 65%)	140,000	
Retained earnings	162,000	
		(302,000)
Goodwill		33,700
Impairment brought forward		(18,000)
Goodwill at date of disposal		15,700

(4) Group profit/loss on disposal of Starkey Ltd

		£
Sale proceeds		427,000
Less: carrying amount of goodwill at disposal (W3)		(15,700)
Carrying amount of net assets at disposal		
Share capital	140,000	
Retained earnings (243,000 + (600,200 x 6/12))	543,100	
		(683,100)
Add back: Attributable to non-controlling interest (683,100 x 35%)		239,085
Loss on disposal		(32,715)

(5) PURP

	%	£
SP	100	32,000
Cost	(85)	(27,200)
GP	15	4,800
X $^{1}/_{4}$		1,200

(6) Retained earnings brought forward

	£	£
Mantia plc (596,300 – 1,006,325)		(410,025)
Add back dividend (500,000 x £1.20)		600,000
Appice Ltd – post acquisition change in net assets		
C/fwd retained earnings	384,200	
Less: retained earnings at acquisition	(136,000)	
Less: profit for the period	(269,920)	
Add back dividend (80,000 x 40p)	32,000	
Less: FV adjustment (70,000 / 10yrs)	(7,000)	
	3,280	
Appice Ltd – 3,280 x 80%		2,624
Starkey Ltd – post acquisition ((243,000 – 162,000) x 65%)		52,650
Less: impairment – Starkey Ltd		(18,000)
		227,249

Retained earnings carried forward (for proof only)

	£
Mantia plc	596,300
Appice Ltd – post acquisition (384,200 – 136,000 – 14,000 – 1,200) x 80%	186,400
Less: impairment – Appice Ltd	(25,000)
Profit on disposal of investment in Starkey Ltd (427,000 – 230,000)	197,000
	954,700

Most candidates made a good attempt at preparing the consolidation schedule and correctly excluded the subsidiary held for sale. Many dealt with the relevant adjustments correctly obtaining all the available marks for this part of the question. Where candidates did make errors it was normally for the following:

- deducting the inventory PURP from revenue rather than adding it to cost of sales or adding it to the cost of sales of the purchasing rather than the selling company.
- calculating the cumulative adjustment to depreciation arising from the fair value adjustment rather than just the current year adjustment and/or entering this into the parent company rather than the subsidiary's column.
- adjusting the subsidiary's profits for the goodwill impairment.
- deducting 100% of the subsidiary's dividend from investment income rather than just the parent company's share of the dividend.

Virtually all candidates attempted to calculate the profit on disposal and a reasonable number arrived at the correct figure. One common error was using the incorrect share capital figure (the shares bought by the parent company rather than total share capital) or ignoring share capital altogether when calculating net assets. Other errors included:

- failing to deduct the impairment from goodwill (many candidates deducted this from the profit on disposal instead).
- failing to add 6/12 of current year profit to brought forward retained earnings or deducting it rather than adding it.
- using retained earnings at acquisition rather than at the date of disposal when calculating net assets at disposal.

A number of candidates produced very disorganised workings for their retained earnings calculation and it was often difficult to understand where numbers had come from and whether they were increasing or decreasing the profit on disposal. Candidates are strongly advised to use the standard pro-forma given in the Learning Material to calculate this figure and label workings appropriately.

Most candidates did prepare a consolidated statement of profit or loss and showed a separate figure for the profit from discontinued operations. However this figure often ignored the profit up to disposal or just took the parent company's share of that profit. Candidates should note that if they only produce the consolidation schedule they will not get the presentation marks available for this statement.

As expected the extract to the consolidated statement of changes in equity was not as well dealt with. Most candidates who attempted this statement did insert the "easy" figures ie the profit for the period and the dividends paid. However errors were frequently made even with these figures by taking total profit for the period rather than just the profit attributable to the owners of the parent company and/or also including the

subsidiary's dividend as a deduction from retained earnings. Some candidates also showed dividends as an addition rather than a deduction to retained earnings. Relatively few candidates attempted to calculate retained earnings b/fwd or c/fwd. Where they did, workings were again often confused and difficult to follow. Few candidates appear to understand that they should take the same approach to calculate consolidated retained earnings as they do to calculate the consolidated retained earnings figure for consolidated statement of financial position questions.	
Total possible marks Maximum full marks	21½ 20

(b) UK GAAP differences
Acquisition of Starkey Ltd The calculation for goodwill is the same under UK GAAP as per IFRS, however under IFRS the parent entity has a choice whether to measure the non-controlling interest at fair value or at the proportion of net assets. Under UK GAAP only the proportion of net assets method is permitted. UK GAAP requires goodwill to be amortised over its useful life and there is a rebuttable presumption that this should not exceed five years. Under IFRS amortisation is not permitted and instead annual impairment reviews take place. *Disposal of Starkey Ltd* UK GAAP requires that a detailed analysis of discontinued operations should be shown on the face of the profit and loss account. However, IFRS only requires a single line to be shown on the face of the statement of profit or loss.
The majority of candidates made a good attempt at this part of the question with many achieving full marks. However a significant number of candidates wasted time by including differences that were not relevant to the scenario such as the treatment of a discount on acquisition. A common misunderstanding is that under UK GAAP goodwill must be amortised over five years rather than it being a maximum useful life.

Total possible marks Maximum full marks	3½ 3