MARK PLAN AND EXAMINER'S COMMENTARY

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

Question 1

Total Marks: 27

General comments

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

Trakehner Ltd

(a) Financial statements

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

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

Statement of financial position as at 30 June 2014

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

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

Workings

(1) Costs matrix

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

(2) PPE

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

(3) Equity

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

(4) Redeemable preference shares

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

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

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

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

Other common errors included the following:

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

Total possible marks	23½
Maximum full marks	22

(b) Financial reporting treatment of redeemable preference shares

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

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

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

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

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

Total possible marks	6½
Maximum full marks	3

(c) UK GAAP differences re borrowing costs

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

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

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

Total possible marks	2
Maximum full marks	2

Question 2

Total Marks: 30

General comments

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

Holstein Ltd

(a) IFRS accounting treatment

(1) Change of depreciation method

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

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

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

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

(2) Government grant

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

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

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

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

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

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

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

(3) Operating lease

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

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

(4) Asset held for sale

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

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

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

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

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

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

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

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

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

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

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

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

Total possible marks	31
Maximum full marks	21

(b) Revised figures

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

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

Total possible marks	5
Maximum full marks	4

(c) Ethical issues

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

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

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

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

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

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

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

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

Total possible marks	11½
Maximum full marks	5

Question 3

Total Marks: 21

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

Appaloosa plc

(a) Profit on disposal of Connemara Ltd

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

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

Total possible marks	3½
Maximum full marks	2

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

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

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

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

Workings

(1) Profit before tax of subsidiary

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

(2) Finance lease liabilities

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

(3) Income tax

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

(4) Non-current assets

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

(5) Revaluation surplus

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

(6) Share capital and premium

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

(7) Retained earnings

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

(8) Non-controlling interest

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

Candidates performed slightly better than they did last time the preparation of a consolidated statement of cash flows was examined (also featuring the disposal of a subsidiary). Although the disposal element of the question would be expected to cause some problems, at this sitting candidates seemed to struggle with even the basics such as arriving at figures for tax paid and interest paid, calculations which are tested at Certificate Level. Many candidates displayed a poor grasp of the fundamentals of double-entry bookkeeping when calculating individual cash flow figures. Those candidates who did not use a T-account approach tended to produce confusing and less structured workings, which had a detrimental impact on the marks earned.

Most candidates set out the statement in a reasonably clear way and therefore gained presentation marks. However, a number of candidates lost marks for not providing sub-totals for the different categories of cash flows.

Most candidates made a good attempt at the reconciliation of profit before tax to cash generated from operations. The majority of candidates gained over half marks on this with the most common error being not to add in the profit before tax for the discontinued operation. Other common errors were to not make adjustments for the discontinued operation in the movement in trade receivables and payables.

Treatment of the disposal of the subsidiary was mixed, with weaker candidates either omitting the impact of the disposal or adjusting for it in the incorrect direction. Only the very best candidates calculated the profit before tax of the subsidiary then used this figure in their reconciliation note, although some others adjusted for the profits for discontinued operations per the question and/or their profit on disposal from Part (a).

The proceeds from the share issue and the net cash impact of the disposal were almost always correctly calculated and a significant majority also correctly calculated the dividend paid by Appaloosa plc. Generally, candidates made a reasonable attempt at the property, plant and equipment T-account and the dividend paid to the non-controlling interest There was no specific recurring error in the property, plant and equipment T-account; it was more that candidates missed one (or more) of the figures. In the non-controlling interest T-account candidates generally missed the disposal figure. The finance lease liability calculation seemed to cause candidates the most problems (other than adjusting for the disposal of the subsidiary).

Total possible marks	16
Maximum full marks	14

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

Present and potential investors

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

Employees

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

Lenders

- Whether loans and interest can be repaid when due

Suppliers and other trade payables

- Likelihood of being paid when due

Customers

- Whether the entity will continue in existence

Governments and trade agencies

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

The public

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

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

Total possible marks	7½
Maximum full marks	5

Question 4

Total Marks: 22

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

Oldenburg plc

(a) Revised gain on bargain purchase

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

Workings

(1) Fair value adjustment to building

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

(2) Adjustment to NCI

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

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

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

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

Total possible marks	5½
Maximum full marks	5

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

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

Workings

(1) Consolidation schedule

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

(2) PURPs

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

(3) Non-controlling interest in year

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

(4) Share of profit of associate

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

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

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

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

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

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

Total possible marks	16
Maximum full marks	14

(c) IFRS v UK GAAP differences

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

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

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

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

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

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

Total possible marks	6½
Maximum full marks	3