MARK PLAN AND EXAMINER'S COMMENTARY

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

Question 1

Total Marks: 31

General comments
Part (a) of this question tested the preparation of a statement of profit or loss and a statement of financial position from a trial balance plus a number of adjustments. Adjustments included property, plant and equipment depreciation, revaluation and impairment, borrowing costs, redeemable preference shares and dividends thereon, and the correction of a prior period error. Part (b) required an explanation of the treatment of the prior period error. Part (c) tested the four measurement bases set out in the IASB Conceptual Framework, with reference to figures provided in the question.

Darwin plc

(a) Financial statements

Statement of profit or loss for the year ended 30 June 2015

	£
Revenue	6,558,550
Cost of sales (W1)	(5,160,050)
Gross profit	1,398,500
Administrative expenses (W1)	(1,018,300)
Distribution costs (W1)	(262,800)
Profit from operations	117,400
Finance cost (15,250 – 1,825 (W4) + 7,125 (W7))	(20,550)
Profit before tax	96,850
Income tax expense (18,600 + 1,500)	(20,100)
Profit for the year	76,750

Statement of financial position as at 30 June 2015

	£	£
Assets		
Non-current assets		
Property, plant and equipment (W2)		915,050
Current assets		
Inventories	175,400	
Trade and other receivables	403,375	
		578,775
Total assets		1,493,825

	£	£
Equity and liabilities		
Equity (W3)		
Ordinary share capital		500,000
Revaluation surplus (W6)		354,750
Retained earnings (W3)		(13,900)
		840,850
Non-current liabilities		
Preference share capital (4% redeemable) (W7)		151,125
Current liabilities		
Trade and other payables	342,750	
Borrowings (100,000 + 40,500)	140,500	
Taxation	18,600	
		501,850
Total equity and liabilities		1,493,825

Workings

(1) Costs matrix

	Cost of sales £	Admin expenses £	Distrib costs £
Per TB	5,106,100	1,008,300	262,800
Opening inventories (266,175 – 100,000)	166,175		
Closing inventories	(175,400)		
Depreciation/impairment charges (8,900 + 3,950 + 50,325) (W2)	63,175	10,000	
	5,160,050	1,018,300	262,800

(2) PPE

	Land and buildings £	Plant and machinery £
Carrying amount b/f (382,000 – 159,100)		222,900
Valuation	600,000	
Depreciation/impairment charges		
Buildings (400,000/40)	(10,000)	
Impairment of machine (W5)		(8,900)
Depreciation on impaired machine (2,700 (W5) + (10,000 x 25% x 6/12))		(3,950)
Depreciation on other machines ((222,900 – 21,600 (OF)) x 25%)		(50,325)
Construction costs		163,500
Borrowing costs (W4)		1,825
	590,000	325,050
Total PPE		915,050

(3) Retained earnings

	£
Per TB	148,100
Less: Issue of redeemable prefs	(150,000)
Prior period adjustment	(100,000)
Add: Interest paid on redeemable prefs (W7)	6,000
Profit for the year	76,750
Transfer from revaluation surplus (W6)	5,250
	(13,900)

(4) Borrowing costs

Cost of loan = (30,000 x 5% x 9/12) + (70,000 x 4% x 3/12) = 1,825

(5) Impairment of machine

	£
CA at 30 June 2014 (38,400 x 0.75^2)	21,600
Less: Depreciation to 31 December 2014 (21,600 x 25% x 6/12)	(2,700)
CA at 31 December 2014	18,900
Less: Value in use	(10,000)
	8,900

(6) Revaluation surplus

	£	£
Valuation		600,000
CA per TB (400,000 – 160,000)		(240,000)
		360,000
Depreciation charge on revalued amount (W2)	10,000	
Depreciation charge on historic cost ((240,000 – 50,000)/40)	(4,750)	
Transfer to retained earnings		(5,250)
		354,750

(7) Redeemable preference shares

Year	Opening balance	Interest expense (4.75%)	Interest paid (4%)	Closing balance
	£	£	£	£
30 June 2015	150,000	7,125	(6,000)	151,125

Most candidates obtained all of the easier marks to gain a solid pass. Better candidates attempted the more challenging adjustments which increased their mark to a very good pass. A significant minority of candidates approached the question in a clear and structured fashion and scored all or almost all of the marks.

Most candidates presented a well laid out statement of profit or loss and included the correct revenue figure. The adjustment to finance costs was often correct, the most common mistake being to add the interest actually paid on the preference shares rather than the interest expense (with a few candidates adjusting for both these figures). Others added the interest capitalised on the borrowing costs rather than deducting it. The majority of candidates also arrived at the correct income tax expense but a good number then went on to also use this figure in the statement of financial position.

Almost all candidates produced a costs matrix working and included the correct figures from the trial balance. Candidates generally included the correct closing inventory and a majority also correctly adjusted opening inventory for the prior period error. Where candidates lost marks here was by using the incorrect bracket convention, for example adding closing inventory rather than deducting it. Most candidates charged depreciation in the costs matrix although a significant number omitted to include the charge for the impairment which they had calculated. A minority of candidates charged depreciation or impairment to the incorrect cost heading even though the question was explicit as to where these costs should be charged, and they lost marks as a result of this.

Presentation of the statement of financial position was not quite as good as the statement of profit or loss. Generally candidates included the correct figures from the trial balance although where these were presented varied. For example, the bank loan repayable on 31 December 2015 was often included in non-current liabilities instead of in current liabilities, and the bank overdraft was often shown within current assets (sometimes as a positive, and sometimes as a negative figure) instead of in current liabilities. A few candidates incorrectly adjusted the inventories figure here for the prior period error.

The preference shares caused problems for many candidates. Most prepared a correct working for the closing balance but included the nominal figure of £150,000 on the face of the statement of financial position. Others presented the preference shares as part of equity. A significant minority of candidates prepared two years of calculations in their working table rather than one, and then included the balance at the end of next year instead of at the end of the current year in their statement of financial position.

A majority of candidates made an attempt at the machine impairment calculation with the correct figure being seen more often than not. As mentioned above, although most candidates prepared this calculation many then failed to make the double entry adjustment for it by including it both in expenses and in their property, plant and equipment working. The most common errors were to calculate accumulated depreciation at the point of classification incorrectly, or to use the wrong figure for the "recoverable amount", generally using the lower of the fair value less costs to sell as opposed to the higher figure as required by IAS 36.

A significant number of candidates tried to do a weighted average working for the borrowing costs rather than a simple pro-rata calculation for the actual interest costs incurred on the specific loan. Almost all candidates did do some kind of calculation and made some adjustment to finance costs, although less then went on to include this figure as part of property, plant and equipment. The best candidates made the correct adjustment for both construction costs and the interest on the borrowings in their property, plant and equipment calculation.

Most candidates prepared a retained earnings working although this was often squashed on the face of the statement of financial position which made it difficult to read. Candidates are encouraged to prepare a separate working where there are more than, say, three adjustments to a figure. The most common error here was to confuse the direction of the adjustments.

A good number of candidates arrived at the correct figure for the initial revaluation surplus although the adjustment then made for the additional depreciation transfer was often incorrect. The most common error was to use the original cost of the property for the historic depreciation. Because the useful life of the property had been reassessed the carrying amount at that date should have been used instead. A minority of candidates transferred the whole of the balance on the revaluation surplus to retained earnings.

Occasionally candidates wasted time by writing out an explanation of the accounting treatment followed, although this was seen less often than in many previous sittings. Where explanation is not explicitly asked for in the requirement there are no marks available for such explanations.

Total possible marks	25½
Maximum full marks	23

(b) Financial reporting treatment of prior period error

Provided that the relevant information was available when the financial statements for the year ended 30 June 2014 were authorised for issue, this should be treated as a prior period error.

Per IAS 8, Accounting Policies, Changes in Accounting Estimates and Errors, a material prior period error should be corrected retrospectively.

Retrospective misstatement means correcting the recognition, measurement and disclosure of amounts as if the error had never occurred. For Darwin plc this means that the comparative amounts for the prior periods need to be restated.

In the statement of profit or loss for the year ended 30 June 2015 the correct opening inventory figure of £166,175 should be recognised/opening inventory is overstated by £100,000. Therefore cost of sales for the current year is overstated/profit understated by £100,000.

The corresponding debit to opening retained earnings will be shown as an in the statement of changes in equity for the year ended 30 June 2015.

A minority of candidates did not attempt this part of the question, and answers overall were disappointing. Although most candidates dealt correctly with this prior period error in Part (a) few were able to explain the accounting treatment here.

A worrying number of candidates thought this was an event after the reporting period (when it fell way outside the definition of such an event per IAS 10), and a minority discussed how inventory should be valued at the lower of cost and net realisable value.

Others were confused as to whether this was an error or simply an adjustment to an accounting policy. Of those candidates who did identify this as a prior period error there was a split as to those who believed it should be adjusted for retrospectively and those who chose prospective adjustment (with some hedging their bets by referring to both).

Total possible marks	5
Maximum full marks	3

(c) The four measurement bases

Historical cost

Assets are recorded at the amount of cash or cash equivalents paid (/amount paid/cost) or the fair value of the consideration given to acquire them at the time of their acquisition.

At historical cost the machine was recorded at its price of £38,400.

Current cost

Assets are carried at the amount of cash or cash equivalents that would have to be paid if the same or an equivalent asset at a similar age and level of use was acquired at the current date.

If the machine was to be measured at its current cost it would have been restated to £23,625 (£56,000 depreciated for 3 years) on 31 December 2014 – representing an "aged" version of the (£56,000) current cost.

Realisable (settlement) value

Assets are carried at the amount of cash or cash equivalents that could currently be obtained by selling the asset in an orderly disposal, ie at £9,500 (11,000 – 1,500).

Present value

Assets are measured at the current estimate of the present discounted value of the future cash flows in the normal course of business.

Under this basis the machine would be measured at £10,000.

Most candidates made a good attempt at this conceptual part. A minority of candidates were clearly confused as to what the measurement bases were and discussed anything from the revaluation to the accrual and the cash bases, or even the qualitative characteristics.

However, the vast majority of candidates did correctly identify the four measurement bases and provided reasonable explanations. A few candidates then went on to waste time by discussing which one was used in the question when calculating the impairment, or was the best to use generally. There were no marks available for these discussions.

The most common omission from answers, which meant that only a small minority gained full marks on the question, was that current cost should be adjusted for the current age and condition of the asset rather than being simply the current price of a new machine.

The most common error was to state that the realisable (settlement) value would be £11,000, rather than that figure less selling costs. A few candidates gave examples of the four bases other than by reference to the figures in Note (3) (as was specified in the requirement) and therefore gained no marks for these examples.

Total possible marks	5½
Maximum full marks	5

Question 2

Total Marks: 31

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 goodwill arising on a business combination, share issues (treasury shares and a subsequent bonus issue), a related party transaction and the sale of a package of goods and services. Part (b) required the calculation of revised figures for profit for the year and number of ordinary shares and of earnings per share (plus comparative figure). Part (c) required an explanation of the ethical issues arising from the scenario and the action to be taken.

Girton plc

(a) IFRS accounting treatment

(1) Goodwill arising on a business combination

Per IFRS 3, Business Combinations, goodwill should be calculated as the excess of the fair value of the consideration transferred plus any non-controlling interest less the fair value of the net assets acquired. When calculating goodwill Alan should therefore have included all three elements of the consideration not just the cash element.

The fair value of any quoted equity investments (ie Girton plc's ordinary shares) should have been taken as the market price at the acquisition date. The deferred consideration should have been accounted for as a liability at the present value of the amount payable.

Consideration is therefore:

	£
Cash	375,000
Ordinary shares (100,000 x £1.20)	120,000
Deferred consideration (147,000/1.05)	140,000
	635,000

The ordinary shares should be credited to ordinary share capital (£100,000) and share premium (£20,000).

The discount on the deferred consideration should be unwound for the period 1 January 2015 to 30 June 2015. This would give a finance cost of £3,500 ((147,000 – 140,000) x 6/12). At 30 June 2015 the deferred consideration would be shown as a current liability of £143,500 (140,000 + 3,500).

Per IFRS 3, the calculation of the fair value of net assets acquired should have included recognition of Downing Ltd's contingent liability, in spite of the fact that this will not have been recognised in Downing Ltd's statement of financial position. The liability existed at 1 January 2015 as the proceedings commenced on 15 December 2014. Once recognised, the contingent liability should be carried at the higher of the amount under IAS 37 (here £Nil) and the fair value at the acquisition date of £75,000, therefore £75,000 should be used.

Fair value of net assets acquired is therefore:

	£
Share capital and retained earnings at 30 June 2015 (200,000 + 356,700)	556,700
Less: Profit 1 January 2015 to 30 June 2015 (6/12 x 245,600)	(122,800)
Contingent liability	(75,000)
	358,900

When calculating goodwill, Alan should have used the fair value method to value the non-controlling interest, as agreed by the board. Goodwill should therefore be calculated as:

	£
Fair value of consideration	635,000
Fair value of non-controlling interest	115,000
Fair value of net assets acquired	(358,900)
	391,100

Intangible assets in the consolidated statement of financial positon as at 30 June 2015 will therefore increase by £341,525 (391,100 – 49,575). An impairment review in accordance with IAS 38, Intangible Assets, should be carried out on this goodwill at every year end.

Non-controlling interest at 30 June 2015 will be stated at £145,700 (115,000 + (122,800 x 25%).

(2) Share issues

Equity instruments reacquired by the entity which issued them are known as treasury shares. Treasury shares should be deducted from equity, and shown as a separate (ie negative) reserve. The original share capital and share premium amounts remain unchanged. No gain or loss should be recognised on the issue, sale, purchase or cancellation of treasury shares.

The bonus issue was based on the correct number of shares (ie 750,000 – see (b)) so 150,000 shares were issued, and ordinary share capital should be credited with this amount. Assuming that Girton plc wishes to maximise distributable profits, the premium should firstly be charged to the share premium account, with the balance going to retained earnings. Therefore £110,000 (90,000 + 20,000 (1)) of this should be debited to share premium and the remaining £40,000 to retained earnings.

(3) Related party transaction

Selwyn Ltd is wholly-owned by one of the close family members of a member of Girton plc's key management personnel, so Selwyn Ltd is a related party of Girton plc. Alan and his son are also related parties of Girton plc. This transaction with Selwyn Ltd is therefore a related party transaction.

Disclosure is required of all related parties and related party transactions, even if the transactions took place on an arm's length basis. The fact that the transactions took place on an arm's length basis may be disclosed, but only if such terms can be substantiated.

Disclosure should be made of:

- The nature of the relationship (a company owned by the son of a director of Girton plc)
- The amount of the transactions (£216,700)
- The amount of any balances outstanding at the year end (£54,400)
- Any provision against outstanding balances and the expense recognised for bad or doubtful debts due from related parties (£20,000).

There is no requirement to identify related parties by name.

Since Selwyn Ltd is in financial difficulties, consideration should be given to making an allowance for the remainder of the debt, ie for an additional £34,400 (54,000 – 20,000).

(4) Revenue recognition

Per IAS 18, Revenue, where a package of goods and services is sold then the components of the package should be identified, measured and recognised as if sold separately.

If the total of the fair values exceed the overall price of the contract the same discount percentage should be applied to each separate component, unless specific discount rates are known.

In this case a package with a usual retail price of £225,000, has been sold for £191,250, ie at a discount of 15%. The two components of the package should be split out and accounted for as follows:

Equipment: Revenue of £148,750 (175,000 x 85%) should be recognised in the year ended 30 June 2015 because the equipment was sold in the year and therefore the risks and rewards of ownership were transferred.

Support services: Revenue of £42,500 (50,000 x 85%) should be accounted for based on the stage of completion. In the absence of other information, on a straight-line basis over the period of the contract (12 months). In the year ended 30 June 2015 only 3/12 of the £42,500 should be recognised as revenue, ie £10,625.

Alan has therefore overstated revenue (and profit for the year) by £31,875 (191,250 – 148,750 – 10,625) and understated liabilities (deferred income) by the same amount.

This part of the question was generally well answered with nearly all candidates discussing all four of the issues. As always weaker answers tended to focus on the figures without giving appropriate supporting explanations.

Issue (1)

This focused on goodwill and many candidates calculated the correct figure. Nearly all recognised that there were three components to the consideration, that shares should be included at their market price and that deferred cash consideration needed to be discounted to its present value. Relatively few candidates discussed the implications of discounting the consideration ie that this would have to be "unwound" between the acquisition and payment dates. Where candidates did address this they often included a full year, rather than six months, of finance cost.

More errors were made with the calculation of net assets at acquisition with a number of candidates omitting share capital. Many struggled to back out six months of current year profit from the year-end retained earnings figure to determine retained earnings at acquisition. Although most candidates did realise that an adjustment was needed for the contingent liability this was sometimes added to net assets or deducted from the goodwill figure calculated. There was often no explanation provided as to why this adjustment needed to be made.

Nearly all candidates included the non-controlling interest at fair value as required in the scenario, but few explained why they were using that figure. Where a reason was given it was often stated as being because "that method usually leads to a higher value of non-controlling interest".

Few candidates discussed the need to carry out an impairment review of goodwill and even fewer attempted to calculate a closing figure for the non-controlling interest

Issue (2)

Answers to this part were mixed with some candidates appearing unable to cope with the two different share transactions and often mixing them up. Many errors were made because candidates did not focus on the specific information given in the question – in particular the timing of the two issues and how, if at all, they had been accounted for.

Most candidates did eventually suggest that the bonus issue should be debited to the share premium account then retained earnings and credited to share capital. However, the figures used were often wrong as many candidates failed to take into account the shares which had been issued on acquisition of the subsidiary.

Most candidates identified that the second transaction related to treasury shares. Most then stated that treasury shares should appear as a debit balance in equity, although fewer suggested that the debit to share capital needed to be reversed out in full. Some candidates appeared to treat the treasury shares as a normal issue of shares. Others credited treasury shares, and split the debit between share capital and share premium.

A minority of candidates wasted time explaining why the company might have chosen to make these share issues.

Issue (3)

Virtually all candidates correctly identified this as a related party transaction. Most attempted to justify their conclusion using the facts from the question and went on to set out the disclosure requirements, using the information from the scenario. A small minority concluded the transaction did not need to be disclosed as the sales had been made at an arm's length price.

Many candidates lost marks by simply repeating definitions and a list of disclosure requirements straight from IAS 24, rather than using the specific information given in the question. Some candidates did discuss the potential need to write down receivables but those that did nearly always overlooked the fact that some of the outstanding balance was already covered by the closing allowance for doubtful debts.

Issue (4)

This was generally well answered and many candidates calculated all the relevant figures correctly. Nearly all candidates recognised that the sale needed to be split into separate components for the sale of goods and the provision of a service.

Almost all candidates recognised that there was a discount to be allocated to both elements and that some of the revenue relating to the helpdesk support needed to be deferred until the following year. Even those candidates who did not realise there was a discount did usually defer the relevant proportion of the service revenue.

Total possible marks	31½
Maximum full marks	22

(b) Revised figures and EPS

Weighted average number of ordinary shares

Date	**Number of shares**	**Number of months**	**Bonus fraction**	**Weighted average**
Per extracts	450,000			
Add back Treasury shares debited in error	200,000			
B/f	650,000	6/12	6/5	390,000
1 January 2015 – on acq of Downing Ltd	100,000			
	750,000	1/12	6/5	75,000
1 February 2015 – bonus issue (750,000/5)	150,000			
	900,000	5/12		375,000
				840,000

	Profit attributable to shareholders of Girton plc £
Per question	574,500
(1) Unwinding of discount	(3,500)
(4) Package of products	(31,875)
	539,125

2015 EPS = 539,125/840,000 = 64.2p

2014 (comparative) EPS = 118.6p x 5/6 = 98.8p

Answers to this part of the question were disappointing as candidates have historically performed well when asked to calculate EPS.

Although most candidates correctly adjusted the draft profit for the adjustment relating to the deferred revenue far fewer adjusted for the “unwinding” of the discount arising from Issue (1) (even where they had covered this in their answer to Part (a)).

A number of candidates made unnecessary adjustments (such as relating to the contingent liability and change in value of goodwill from Issue (1) or adjusting for the receivable already provided for in Issue (2)). This indicates that such candidates lack an understanding of the double entry relating to these issues.

Most candidates (although by no means all) made an attempt at a weighted average share capital working although the timings of the share issues and subsequently the relevant number of months were usually incorrect. Most of these candidates took into account the impact of the bonus issue and correctly calculated and used the bonus fraction. Although most candidates did eventually calculate a current year EPS figure fewer correctly restated the prior year figure to reflect the bonus issue made in the current year.	
Total possible marks Maximum full marks	6 4

(c) Ethical issues

Alan's financial accounting knowledge seems lacking, given that he failed to take the contingent liability and the deferred consideration into account when calculating goodwill. As an ICAEW Chartered Accountant Alan is obliged to comply with the ICAEW code of ethics, including the principle of professional competence and due care, and should keep his knowledge up to date.

He makes other "errors", all of which have the effect of either understating the number of ordinary shares in issue, or overstating the profit for the year, with the result that EPS for the current year, to which Alan's bonus is linked, is massively overstated. There is a clear self-interest threat here for Alan as the directors' bonuses are linked to profit. In accordance with the code of ethics, Alan should have ignored this self-interest threat and prepared the figures accurately, in accordance with the principles of objectivity, independence and professional behaviour.

The fact that Alan has failed to disclose the related party relationship/transaction with his son's company also points to a possible lack of integrity. More so, if Alan engineered the sale and knew that his son's company was in financial difficulties.

You should take the following action:

- Discuss each of the errors found with Alan, explaining the correct IFRS accounting treatment to him.
- If Alan appears genuinely to be out of date tactfully suggest that he goes on an update course.
- Ensure the financial statements are corrected.
- If Alan refuses to amend the financial statements seek support from the managing director.
- Document all discussions.
- If you find yourself in a difficult situation, eg, caught between the FD and the MD, or subject to any sort of intimidation threat, then consult the ICAEW helpline.

This part, covering ethics, was generally well answered with candidates reacting well to the "clues" provided in the scenario. Almost all candidates recognised the potential impact of the directors' bonus being linked to EPS and there were some excellent answers discussing the impact of the errors from Part (a) of the question and questioning the integrity of the finance director. Most candidates also correctly identified a potential intimidation threat to the financial controller. As ever, weaker candidates placed themselves in an audit context and suggested a review of Alan's work and referral to the ethics partner.	
Total possible marks Maximum full marks	9½ 5

Question 3

Total Marks: 17

General comments
This was a mixed topic question. Part (a) required candidates to calculate the correct closing inventory figure, after a valuation error had been made. Part (b) required the preparation of extracts from the statement of profit or loss and statement of financial position for a finance lease taken out during the year. Part (c) required candidates to redraft a single entity statement of cash flows, correcting for the above matters and other errors.

Peterhouse Ltd

(a) Calculation of closing inventories

	£	£
Original figure		135,800
Adjustments re Perro		
WIP at NRV (2,000 x ((25 x 70%) – 1 – 3))	27,000	
Less: WIP at cost (2,000 x £15)	(30,000)	
FG at NRV (1,000 x ((25 x 70%) – 1)	16,500	
Less: FG at cost (1,000 x £18)	(18,000)	
Total decrease to closing inventories		(4,500)
		131,300

Most candidates made some attempt at this part of the question, however answers were mixed.

Most candidates were able to calculate the correct cost figures for both finished goods and work in progress but many struggled with the net realisable value calculations. Candidates often made a reasonable attempt at the net realisable value for finished goods but failed to perform any calculation for the net realisable value of the work in progress.

Some candidates carried out various (sometimes seemingly random) calculations, but it was unclear how they impacted on the draft inventory figure. A worrying number of candidates actually arrived at a higher figure than the original one. Nonetheless, a good number of candidates did achieve full marks.

Total possible marks	4½
Maximum full marks	3

(b) Finance lease extracts

Statement of profit or loss for the year ended 30 June 2015 (extracts)

	£
Cost of sales ((29,786 (W1) ÷ 3) – (8,000 x 2))	6,071
Finance costs (W2)	(1,089)

Statement of financial position as at 30 June 2015 (extracts)

	£
Non-current assets	
Property, plant and equipment (29,786 (W1) – 9,929)	19,857
Non-current liabilities	
Finance lease liabilities	7,619
Current liabilities	
Finance lease liabilities (14,875 – 7,619) (W2)	7,256

Workings

(1) Present value of minimum lease payments

Date of payment	PV calculation	£
1 July 2014	8,000	8,000
30 June 2015	8,000 / 1.05	7,619
30 June 2016	$8,000 / 1.05^2$	7,256
30 June 2017	$8,000 / 1.05^3$	6,911
		29,786

(2) Lease table

Year ended	B/f		Interest @ 5%	Payment	C/f
		£	£	£	£
30 June 2015	(29,786 – 8,000)	21,786	1,089	(8,000)	14,875
30 June 2015		14,875	744	(8,000)	7,619

Almost all candidates who attempted this part of the question prepared a finance lease table working. Occasionally candidates failed to deduct the initial deposit from the opening balance or prepared the table based on payments in advance rather than in arrears.

A smaller number of candidates were able to correctly transfer figures from their table into their financial statement extracts. Some presented figures the wrong way round between current and non-current, or showed the lease payment as a current liability rather than using the figure from their table. Others failed to use the same figure to calculate the carrying amount of property, plant and equipment as they had used in their table. However, it was pleasing to see that the majority of candidates had made a reasonable attempt at the financial statement extracts.

The two most disappointing aspects of answers were that most candidates:

- simply used the fair value of the asset as the opening balance in their finance lease table rather than calculating the present value of the minimum lease payments; and
- depreciated the asset over four, rather than three, years.

However, most candidates still achieved a good mark for this part of the question and a significant number of candidates achieved full marks.

Total possible marks	7½
Maximum full marks	6

(c) Revised statement of cash flows for the year ended 30 June 2015

	£	£
Cash flows from operating activities		
Cash generated from operations (W)	991,600	
Interest paid (2,100 + 1,089 – 1,500)	(1,689)	
Income tax paid	(195,500)	
Net cash from operating activities		794,411
Cash flows from investing activities		
Purchase of property, plant and equipment (1,041,200 + 15,600)	(1,056,800)	
Proceeds from sales of property, plant and equipment	17,200	
Net cash from investing activities		(1,039,600)
Cash flows from financing activities		
Proceeds from issue of ordinary share capital (150,000 x £1.50)	225,000	
Payment of finance lease liabilities (16,000 – 1,089 (b))	(14,911)	
Ordinary dividend paid (23,900 + (150,000 x 50p))	(98,900)	
Net cash from financing activities		111,189
Net decrease in cash and cash equivalents		(134,000)
Cash and cash equivalents at 1 July 2014		49,150
Cash and cash equivalents at 30 June 2015 (150 – 85,000)		(84,850)

Working

Cash generated from operations

	£
Per draft	978,700
Decrease in cost of sales re lease (8,000 x 2) (b)	16,000
Less profit on sale of PPE (17,200 – 15,600)	(1,600)
Adjustment to movement in trade and other payables for accrued interest	(1,500)
	991,600

Answers were disappointing and a minority of candidates failed to attempt this part. Although some candidates did achieve good marks it was unusual to see full marks.

Adjustments to cash generated from operations were frequently rather random with even those candidates who had the correct figures often making their adjustments in the wrong direction. A significant number of candidates hedged their bets (in this working or on the statement of cash flows) by including only one side of a bracket around figures, so it was unclear whether they intended it to be added or subtracted.

The most common correct adjustment seen was the negative £1,500 in respect of the opening and closing interest accrual. The next was the removal of the profit on sale of property, plant and equipment. An adjustment for the lease payments wrongly debited to cost of sales was rarely seen. Many candidates adjusted for the change in inventory valuation from Part (a) failing to appreciate that this had no impact as it affected both operating profit and the movement in inventories for the year.

Most candidates included the correct income tax paid figure, although a few did not show this in brackets (or included only one bracket). The calculations for interest paid were mixed although the most common figure seen was £600, which ignored the interest on the finance lease calculated in Part (b). Proceeds from the sale of property, plant and equipment was often included, and where they were, it was usually both the correct figure and shown as a positive.

The most common error for the purchase of property, plant and equipment was to deduct the cash proceeds rather than add them. If a figure was included for the finance lease then it was generally only the payments made rather than that figure net of the interest. A figure for the proceeds from the share issue was usually given, although this was often the nominal figure rather than the total cash received. T-account workings were at best rather random and usually had figures on the wrong side or were incomplete.

Candidates often failed to complete their statement of cash flows by not showing sub-totals or not completing the total for cash and cash equivalents at the end of the year. A significant number of candidates left the adjustment for the increase in the overdraft as part of financing activities rather than appreciating that this should have been shown as part of cash and cash equivalents at the end of the period.

Total possible marks	10
Maximum full marks	8

Question 4

Total Marks: 21

General comments
This was a consolidated statement of profit or loss question, featuring two subsidiaries (one acquired during the year) and one associate. The associate had made losses since acquisition, such that the share of the loss taken for the current year had to be restricted. Other adjustments included a fair value adjustment on acquisition, a gain on bargain purchase of the subsidiary acquired during the year, an intra-group sale of a non-current asset (with subsequent impact on the annual consolidated statement of profit or loss) and intra-group management charges. The non-controlling interest column from the consolidated statement of changes in equity was also required. Part (b) required a description of the differences between IFRS and UK GAAP in respect of the preparation of consolidated financial statements.

Pembroke Ltd

Consolidated statement of profit or loss for the year ended 30 June 2015

	£
Revenue (W1)	2,146,000
Cost of sales (W1)	(1,447,100)
Gross profit	698,900
Operating expenses (W1)	(257,300)
Profit from operations	441,600
Share of loss of associate (W3)	(3,000)
Profit before tax	438,600
Income tax expense (W1)	(94,300)
Profit for the period	344,300
Profit attributable to	
Owners of Pembroke Ltd (β)	309,340
Non-controlling interest (W4)	34,960
	344,300

Consolidated statement of changes in equity for the year ended 30 June 2015 (extract)

	Non-controlling interest £
Balance at 1 July 2014 (W4)	184,440
Total comprehensive income for the year	34,960
Added on acquisition of subsidiary ((400,000 + 175,000) x 30%)	172,500
Balance at 30 June 2015 (β)	391,900

Workings

(1) Consolidation schedule

	Pembroke Ltd	Newnham Ltd	Trinity Ltd (8/12)	Adj	Consol
	£	£	£	£	£
Revenue	945,200	754,800	470,000	(24,000)	2,146,000
Cost of sales – per Q	(583,700)	(573,600)	(279,000)		
– PPE PURP (W5)			(10,800)		(1,447,100)
Op expenses – per Q ((122,550 – 12,000) x 8/12)	(128,900)	(116,400)	(73,700)	24,000	
– FV deprec (120,000/25 yrs)		(4,800)			
– Gain on bargain purchase* (W6)	42,500				(257,300)
Tax	(60,000)	(13,000)	(21,300)		(94,300)
		47,000	85,200		

*Or show on face of consolidated statement of profit or loss

(2) Share of loss of associate (Wolfson Ltd)

	£
Original cost	118,200
Share of post-acquisition change in NAs ((181,900 + (120,600 – 14,500)) x 40%)	(115,200)
Carrying amount of associate at 30 June 2014	3,000

Share of loss in year = 14,500 x 40% = 5,800 – restricted to £3,000

(3) Non-controlling interest in year

	£
Newnham Ltd (20% x 47,000 (W1))	9,400
Trinity Ltd (30% x 85,200 (W1))	25,560
	34,960

(4) Non-controlling interest brought forward (Newnham Ltd)

	£
At acquisition (20% x (500,000 + 301,000 + 120,000))	184,200
Share of post-acquisition profits (20% x (363,600 – 51,800 – 301,000 – (4,800 (W1) x 2)))	240
	184,440

(5) PPE PURP (Trinity Ltd)

	£
Asset now in Pembroke Ltd's books at £51,000 x 4½/5	45,900
Asset would have been in Trinity Ltd's books at £39,000 x 4½/5	(35,100)
	10,800

(6) Gain on bargain purchase (Trinity Ltd)

	£
Consideration transferred	360,000
Net assets at acquisition (400,000 + 175,000)	(575,000)
Non-controlling interest at acquisition (575,000 x 30%)	172,500
	(42,500)

(7) Non-controlling interest carried forward (for proof only)

	£	
Newnham Ltd		
At acquisition (W4)	184,200	
Share of post-acquisition profits (20% x (363,600 – 301,000 – (4,800 (W1) x 3))	9,640	
		193,840
Trinity Ltd		
At acquisition (SCE)	172,500	
Share of post-acquisition profits (W3)	25,560	
		198,060
		391,900

Answers were very disappointing. The majority of candidates did produce a consolidated statement of profit or loss with a supporting consolidation schedule. However, a minority chose to merge the consolidation schedule working into the consolidated statement of profit or loss, and as a result did not earn presentation marks.

The majority of candidates did time apportion the new subsidiary's results for the correct number of months. A minority consolidated for the full year or used an incorrect number of months.

Common errors in the consolidation schedule included:

- entering the contra for the management charges in the wrong column and/or to cost of sales rather than to operating expenses
- adjusting for the proceeds from the intra-group sale of a machine as if those proceeds would have been treated as revenue
- splitting the provision for unrealised profit on the intra-group sale of the machine between the parent and subsidiary columns (such that £12,000 appeared in one column and £1,200 in another, rather than the correct net £10,800 being shown in the subsidiary's column)
- incorrectly calculating the provision for unrealised profit on the machine or not realising that the profit on disposal should be reduced rather than increased by the subsequent difference in depreciation
- including the cumulative increase to depreciation arising from the fair value adjustment rather than just adjusting for the current year's depreciation
- including a prior year impairment rather than the gain on bargain purchase on the current year acquisition
- failing to deal correctly with the consultancy fees (which did not arise evenly over the year).

Having arrived at the consolidated profit for the period, almost all candidates allocated the profit between the parent and the non-controlling interest. A minority of candidates used the figures from the question to perform this calculation instead of the adjusted figures from their consolidation schedule. Others failed to show what figure they had multiplied by what percentage to arrive at their non-controlling interest figure.

Answers to the non-controlling interest column from the consolidated statement of changes in equity were even more disappointing. Frequently this was not attempted at all and where it was attempted presentation was poor. The most the majority of candidates managed to do was to enter the non-controlling interest share of the profit for the year.

Some did attempt to calculate the non-controlling interest arising on the subsidiary acquired in the year but frequently made this much more complicated than the simple calculation required and often ended up with an incorrect figure. A minority attempted to calculate the non-controlling interest brought forward, but workings were often disorganised and difficult to follow.

Many candidates wasted time preparing completely unnecessary workings and often failed to realise that this figure would not include anything for the subsidiary acquired in the year. However, a significant number of the better-prepared candidates did correctly calculate both this figure and that for the non-controlling interest arising on the subsidiary acquired in the year.

Although almost all candidates calculated a figure for the share of the associate's losses this was frequently treated as a profit rather than a loss and some candidates seemed to be including some form of investment in the associate in their profit or loss account figure. Hardly any candidates understood the impact of a loss-making associate and the requirement to "cap" losses to prevent a "negative" investment in associate figure.	
Total possible marks Maximum full marks	19½ 17

(b) IFRS v UK GAAP differences re preparation of consolidated financial statements

UK GAAP	IFRS
- Requires goodwill to be amortised over its useful life, with rebuttable presumption that this should not exceed five years	- Goodwill is subject to annual impairment review
- Impairment losses re goodwill may be reversed	- Impairment losses cannot be reversed
- Acquisition related costs added to cost of acquisition	- Acquisition related costs are expensed
- Negative goodwill presented on the statement of financial position directly under positive goodwill, as a negative asset	- Negative goodwill recognised in profit or loss/retained earnings
- Non-controlling interest must be measured using the proportionate method	- Can use the proportionate method or the fair value method
- A subsidiary should be excluded from consolidation where severe long-term restrictions apply or where the interest is held exclusively for resale	- No allowed exclusions from consolidation
- Where a subsidiary is disposed of and meets the definition of a discontinued operation its results are shown in a separate column in the consolidated income statement	- The results of the subsidiary are shown as a single amount on the face of the consolidated statement of profit or loss
- Recognises implicit goodwill on the acquisition of an associate or joint venture and requires it to be amortised	- No separate goodwill recognised

As usual for parts of questions testing UK GAAP differences answers were mixed. Many candidates wasted time and gained no marks by just listing out random differences on a variety of topics rather than focusing, as required, on differences relating to consolidated financial statements. Those that did focus on differences relating to consolidated financial statements usually gained at least half of the available marks for the more obvious points on the different methods of calculating goodwill and amortisation versus annual impairment reviews. Well-prepared candidates achieved full marks on this part.	
Total possible marks Maximum full marks	10 4