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:

General comments
Part (a) of this question tested the preparation of a statement of profit or loss, a statement of financial position and a provisions note from a draft set of financial statements with a number of adjustments required. Adjustments included deferred revenue, foreign exchange difference, a provision with discounting and a convertible bond as well as adjustments to property, plant and equipment.

Part (b) tested the difference between the presentation of financial statements prepared using IFRS and UK GAAP. Part (c) asked for explanations of the concepts of substance over form, present fairly and true and fair view with illustration to the financial statements prepared in Part (a).

(i) Gamow Ltd – Statement of financial position as at 31 March 2015

	£	£
ASSETS		
Non-current assets		
Property, plant and equipment (W4)		1,207,020
Intangibles		160,000
		1,367,020
Current assets		
Inventories	47,300	
Trade and other receivables (121,240 – 880 (W3))	120,360	
Cash and cash equivalents	3,800	
		171,460
Total assets		1,538,480
Equity		
Ordinary share capital	580,000	
Other share reserve (share options / warrants) (W7)	22,782	
Retained earnings (541,720 – 779,890 + 336,900)	98,730	
Equity		701,512
Non-current liabilities		
Bond (W6)	284,168	
Provisions (note)	112,150	
Deferred income (250,000 x 3/24) (W2)	31,250	
		427,568
Current liabilities		
Trade and other payables (92,400 + 18,000 (W7))	110,400	
Deferred income (100,000 + (156,250 (W2) – 31,250))	225,000	
Taxation	74,000	
		409,400
Total equity and liabilities		1,538,480

(ii) Gamow Ltd – Statement of profit or loss for the year ended 31 March 2015

	£
Revenue (1,896,200 – 156,250 (W2) – 100,000 (W2))	1,639,950
Cost of sales (W1)	(683,310)
Gross profit	956,640
Administrative expenses	(337,360)
Other operating costs	(174,533)
Operating profit	444,747
Finance costs (1,560 + 7,337 (W6) + 24,950 (W7))	(33,847)
Profit before tax	410,900
Income tax	(74,000)
Profit for the year	336,900

(iii) Provisions note

	£
At 1 April 2014	–
Profit or loss charge (W6)	104,813
Unwinding of discount	7,337
At 31 March 2015	112,150

This provision is in relation to a legal claim which arose on 1 April 2015 due to the delivery of faulty goods to a customer. The incident was one-off in nature due to a fault with one of the machines. The provision has been discounted to a present value of 7%. The legal claim is likely to be settled in April 2016.

Workings

W1 Expenses

	Cost of sales	Admin expenses	Other operating costs
	£	£	£
Draft	567,430	283,600	189,720
Exchange loss (W3)	880		
Provision adjustment (120,000 – 104,813)			(15,187)
Research & development costs (W5)	115,000		
Depreciation charge (W4)		51,360	
Loss in disposal (W4)		2,400	
	683,310	337,360	174,533

W2 Revenue

Loyalty cards (200 x £1,250) = £250,000
£250,000 x 9/24 months = £93,750 revenue
Deferred income (250,000 – 93,750) £156,250

Mendel pre-orders (2,000 x £50) = £100,000

W3 Foreign exchange

	£
Translation at 1 January 2015 (22,000 x 0.83)	18,260
Translation at 31 March 2015 (22,000 x 0.79)	(17,380)
Exchange loss	880

W4 Property, plant & equipment

	Land & buildings £	Plant & machinery £
Cost	1,080,000	384,900
Less: disposal (cost)		(19,500)
		365,400
Depreciation charge for the year		
1,080,000 / 40yrs	(27,000)	
365,400 / 15yrs		(24,360)

Disposal – carrying amount
(19,500 – (19,500 / 15yrs) x 6yrs) = 11,700

PPE – carrying amount at 31 March 2015	£
At 1 April 2014	1,260,780
Less: depreciation (27,000 + 24,360)	(51,360)
Less: disposal adj (11,700 – 9,300)	(2,400)
At 31 March 2015	1,207,020

W5 R&D Project – Mendel

	Intangible asset £	Expense £
Background investigation work		25,000
Initial development work		42,800
Second phase development work	160,000	
Product launch costs		31,600
Staff training		15,600
	160,000	115,000

W6 Provision

120,000 / 1.07^2 = 104,813
Unwinding of discount: 104,813 x 7% = 7,337

W7 Convertible bond

	Cash flow £	Discount factor @ 9%	Present value £
31 March 2015	18,000	1/1.09	16,514
31 March 2016	18,000	$1/1.09^2$	15,150
31 March 2017 (redemption)	318,000	$1/1.09^3$	245,554
Liability component			277,218
Equity component (bal fig)			22,782
Total			300,000

1 April 2014 £	Interest (9%) £	Payment (6%) £	31 Mar 2015 £
277,218	24,950	(18,000)	284,168

Presentation of the statement of profit or loss and statement of financial position varied. Although as indicated as acceptable at the tutor conference, most candidates omitted sub-totals on the statement of financial position, many also omitted totals for total assets and total equity and liabilities on this statement and/or sub-totals on the statement of profit or loss and were penalised accordingly. However, there were few very messy statements in terms of workings shown on the face of the statements. Most candidates did use the recommended “costs matrix” in their workings and fewer than usual lost marks by mixing up bracket conventions. However, a worrying number of candidates were let down by difficult to read handwriting.

Presentation of the provisions note was poor. Many candidates seemed to have little idea what this note should look like, with many notes looking more like a property, plant and equipment note, featuring "additions" for the year. In addition, a number of candidates gave an explanation for how they had arrived at the closing balance (rather like an answer to an "explain" type question), rather than the narrative that should accompany such a note. Although most candidates arrived at the correct closing balance of £112,150, this was mainly achieved by discounting the gross provision of £120,000 by 7% for one year, to the current year end. Even those who correctly discounted by two years, usually failed to show this correctly in the movement note. Others mixed up the unwinding charge with the correction of the error (from £120,000 to £104,813) with different figures shown either in the costs matrix and/or as a finance charge.

However, many candidates did achieve high marks on this question with many arriving at completely correct figures in respect of revenue and the associated deferred income, the foreign exchange adjustment, the depreciation charges, and the loss on sale. A good number also arrived at the correct split for the convertible bond between equity and debt, and correctly amortised the latter. Where mistakes were made over the convertible bond they included failing to accrue for the £18,000 interest, taking the net of the true interest and the nominal interest to finance charges, adding the equity element to ordinary share capital when it should have been shown separately and failing to amortise the debt from its base figure.

Fewer candidates than might have been anticipated arrived at the correct split between research and development costs to be capitalised and those to be expensed. The most common error was to capitalise the product launch costs instead of expensing them.

Other common errors included arriving at an incorrect foreign exchange adjustment by using the rate at settlement, as opposed to the year-end rate, deducting the foreign exchange adjustment from revenue instead of adding it to costs, when calculating closing retained earnings adding the revised profit for the year but failing to take out the draft profit for the year and reducing the plant and machinery by the carrying amount of the disposed of asset instead of by the cost (the cash proceeds had already been credited there), before calculating the depreciation charge for the year. Candidates also need to be reminded that unless they show their workings then they will lose calculation marks unless the resultant figure is completely correct, this was particularly prevalent in the calculation of the depreciation charge on plant and machinery (ie what figure had been divided by how many years).

Total possible marks	30
Maximum full marks	27

(b) UK GAAP – Presentation of financial statements

Under UK GAAP the presentation of financial statements is primarily dealt with by the Companies Act 2006 and FRS 102. The Companies Act sets out the balance sheet and profit and loss account formats, in general the requirements are similar to those of IAS 1.

However, it should be noted that the formats in IAS 1 are only contained in the 'Guidance on Implementation' whereas the Companies Act formats are enshrined in law.

Under UK GAAP the profit and loss account format requires less detail to be included than in IAS 1, although IAS 1 allows some of the additional detail to be presented in the notes rather than on the face of the statement.

The Companies Act balance sheet format is less flexible than the equivalent IAS 1 statement of financial position. A UK balance sheet is usually prepared on a net assets basis.

Different terminology is used, as already described above the Companies Act uses a balance sheet and a profit and loss account as opposed to a statement of financial position and a statement of profit or loss. In addition, other terms are different for example, inventories are called stock, receivables are called debtors, property, plant and equipment is called tangible fixed assets.

Different presentation is used between UK GAAP and IFRS. For example, for discontinued operations, UK GAAP requires a separate column to be presented on the face of the profit and loss account. However under IFRS a single line is required for profit or loss from such activities. Another relevant example is the presentation of held for sale assets as these will simply be included as part of tangible fixed assets under UK GAAP. However, a separate line is presented below current assets for such assets under IFRS.

This part of the question was poorly answered with many candidates setting out seemingly "random" differences between IFRS and UK GAAP accounting treatments, when the requirement asked for differences in *presentation*. Very few candidates referred to the fact that IFRS presentation is guided by IAS 1 and UK GAAP presentation dictated by the Companies Act 2006. The most common answer referred to differences in the names of the statements and gave a few examples of differences in terminology (eg inventories as opposed to stock). The better answers then set out the differences in presentation for held for sale assets and discontinued operations, both of which were relevant points.

Total possible marks	8
Maximum full marks	4

(c)(i) Substance over form

Substance over form is the principle that transactions and other events are accounted for and presented in accordance with their broader substance and economic reality and not their legal form. Substance over form should be applied to all accounting areas in accordance with the IASB Conceptual Framework.

The main example of substance over form included in Gamow Ltd's financial statements above is the treatment of the convertible debt.

Gamow Ltd has a convertible bond which is a hybrid financial instrument containing both a liability component and an equity component. The substance of the financial instrument is the same as issuing separately a non-convertible bond and an option to purchase shares. The substance of the instrument is followed and therefore separate liability and equity components are accounted for, rather than following its legal form of a financial liability.

Another example could be argued to include the process of recording deferred income rather than recognising the cash proceeds immediately, although this is more akin to the accruals concept. The capitalisation of development costs is another example with the link between their nature being that of an expense however in substance they may meet the definition of an asset, per the Conceptual Framework and hence capitalised.

(ii) Fair presentation and true and fair

IAS 1 Presentation of financial statements requires financial statements to 'present fairly' the financial performance and position of an entity. This means that the effects of transactions should be faithfully represented. This is generally achieved by presenting the financial information in accordance with International Accounting Standards.

In the UK, the Companies Act 2006 requires that financial statements present a 'true and fair view' of the company's financial position and of its profit or loss for the period. True and fair is usually defined in terms of generally accepted accounting practice, which in the UK means compliance with accounting standards and adherence to the Companies Act requirements. 'True' is generally interpreted as reflecting factual accuracy and 'fairness' as indicating that the view is unbiased (neutral) and objective.

Answers to this part of the question were varied and generally disappointing. Many candidates could only state that substance over form means "accounting for an item's substance instead of its form"! Very few candidates referred to economic or commercial reality compared to legal form. Most candidates cited the convertible bonds as an example, but some then went on to say that their legal form was equity, and the substance a liability, even where they had treated the bonds as a compound financial instrument in their answer to Part (a). Other examples, such as leasing, which did not feature in Part (a) earned no marks.

The concepts of "present fairly" and "true and fair view" were also poorly explained by the majority of candidates, with only a minority referring to such matters as faithful representation, accuracy and a lack of bias. A number of candidates believed that "present fairly" is concerned with the fair value of assets. Others couched their explanation of a "true and fair view" in the context of an audit report. It was very rare to see the basic fact that "present fairly" is an IFRS concept, and "true and fair view" the equivalent in UK GAAP, and even if this fact was presented few then went onto to say that these concepts could be achieved by compliance with accounting standards.

Total possible marks	8
Maximum full marks	6

Question 2

Total Marks:

General comments
Part (a) of this question required candidates to explain the IFRS financial reporting treatment of the four issues given in the scenario. The issues covered a government grant, a sale and leaseback, two possible held for sale assets with impairment issues and the purchase of own shares.

Part (b) required the calculation of revised figures for profit before tax and equity.

(a)

(1) Government grant

This is an income related grant and should therefore be recognised over the period to which the related expenditure is being incurred. For Meitner plc it is expected to employ local employees over a three year period, therefore it would be reasonable to assume that the grant should be recognised over the three years also.

The grant should not be recognised unless there is reasonable assurance that the entity will comply with any conditions attached to the grant and the grant will be received. Meitner plc has already received the grant and has currently met the condition that the local workforce makes up a third of the total employees as it has 35% local employees and this is expected to rise. So both conditions have been met. However, the grant should not be recognised in the statement of profit or loss in full upon receipt regardless of whether it is assessed as being not likely to be repaid.

£125,000 (£375,000 / 3yrs) of income should be recognised for the year ended 31 March 2015. The remaining £250,000 should be reversed from other income and recognised as deferred income, as part of liabilities. The liability should be split equally between current and non-current.

(2) Sale and operating leaseback

Sale and leaseback transactions can result in either a finance or an operating lease. The length of the lease of five years in comparison to the life of the property of 30 years, so this is a sale and operating leaseback.

The substance of the transaction arising from the sale and immediate leaseback on a short-term lease of five years is that of a sale. The risks and rewards of ownership are not substantially reacquired when the leaseback is an operating lease and have passed instead to the lessor. Therefore, a profit or loss on disposal should be recognised. Meitner plc has correctly recognised the transaction as a disposal.

The amount of profit to be recognised will depend on the amount of the sale proceeds in comparison with the property's fair value. Here the sale proceeds are above the fair value of £7.3 million, and therefore the excess of £700,000 (£8m – 7.3m) should be deferred and amortised over the period which the asset is expected to be used (ie the length of the lease of 5 years).

Profit on disposal is made up of two elements:

	£	£
Proceeds	8,000,000	
Fair value	(7,300,000)	
Deferred profit		700,000
Fair value	7,300,000	
Carrying amount	(6,500,000)	
Profit to be recognised immediately		800,000
Total profit		1,500,000

£700,000 of profit should therefore be removed from other income and instead recognised as deferred income as part of liabilities and recognised evenly over five years. At 31 March 2015, 9 months of deferred income should also be recognised as part of profit or loss, being £105,000 (£700,000 x 9/60). Deferred income at 31 March 2015 will be £595,000 (700,000 – 105,000).

(3) Held for sale assets

IFRS 5 Non-current assets held for sale and discontinued operations requires that a non-current asset should be classified as held for sale when the entity intends to recover its carrying amount principally through sale rather than continuing use.

In order for the properties to be classified as held for sale they must be available for immediate sale, both of which are and the sale must be highly probable. Highly probable is defined as:

- Management must be committed to a plan to sell the properties, which they are at both locations by fulfilling the requirements below;
- There must be an active programme to locate a buyer, which is the case as the properties are being advertised in the relevant trade press;
- The assets must be marketed for sale at a price that is fair, in both cases a professional valuation was obtained;
- The sale should be expected to take place within one year from the date of classification. The property at Ostwald is expected to be sold within this time frame however, the property at Dirac won't be sold until the road restructure is finalised which is expected to take longer than a year, so it is unlikely to be sold within the year;
- It is unlikely that significant changes to the plan will be made, or the decision reversed. This is unlikely to be the case as the operations have moved to the new central location.

It therefore seems reasonable to conclude that the property at Dirac should continue to be held as part of non-current assets and depreciated. It is possible that the Dirac property did meet the held for sale criteria at 1 December, however at some point prior to the year end it was decided that the property should not be sold until the uncertainty regarding the planning permission was resolved. As no specific information was provided regarding the date of this decision it seems reasonable to assume that the asset should not be treated as held for sale. Its' treatment is therefore correct.

However, the current valuation suggests that an impairment has taken place as the carrying amount exceeds its recoverable amount. Recoverable amount is higher of value in use and fair value less costs to sell. A value in use figure has not been provided, however it would be unlikely that this would be higher as the operations have been moved from the Dirac property.

At 1 December 2014 an impairment of £164,997 (1,323,000 – (1,169,700 x 99%)) should be recognised. The property should then be depreciated based on its revised value of £1,158,003 over the property's remaining life at 1 December 2014 of 21 years. Therefore reverse the excess depreciation charge of £2,619 (21,000 – 18,381):

Based on cost: ((1,890,000 / 30yrs) x 4/12) = £21,000
Based on impaired amount: ((1,158,003 / 21yrs) x 4/12) = £18,381

However, the property at Ostwald does meet all of the conditions and should therefore be separately disclosed as a 'held for sale' asset. The property should no longer be depreciated from the date it meets the held for sale criteria, being 1 December 2014. So the depreciation from 1 December 2014 to 31 March 2015 needs to be reversed. So depreciation of £15,250 ((1,372,500 / 30yrs) x 4/12) needs to be removed from profit or loss and added back to non-current assets.

The property should be recognised at the lower of its carrying amount of £976,000 and its fair value less costs to sell of £1,280,500 (1,300,000 x 98.5%), so at £976,000. As the property will continue to be held at its current carrying amount there is no impairment to be recognised. The potential gain on the sale of the property should be recognised at the point of sale, when it is realised.

(4) Purchase of own shares

When an entity purchases its own shares, the shares should be recognised as treasury shares as a negative reserve within equity. The amount recognised is the amount that Meitner plc paid to reacquire the shares, being £210,000 (150,000 x £1.40). No gain or loss should be recognised on their repurchase or subsequent resale. The original share capital, and share premium if relevant, recognised when the shares were originally issued should remain unchanged.

£210,000 should be removed from investments and instead recognised as part of equity.

This question was reasonably well answered with nearly all candidates attempting all four of the issues. As always some candidates lost easy marks by focusing on the calculations without sufficient accompanying explanations.

(1) Government grant: This was generally well answered with nearly all candidates identifying that the recognition criteria for the grant had been met and that it should be spread over three years. Most candidates also correctly calculated the amount of the grant to be recognised in the current year and that the balance should be included as deferred income split equally between a current and non-current liability. Fewer candidates specifically stated that it was a grant related to income and in fact a significant number of candidates wasted time by discussing the alternative treatments available for grants relating to assets which was simply not relevant in this scenario. Other candidates wasted time by discussing what might happen in future years (particularly if the grant became repayable) when the requirement only asks for the accounting treatment in the current year. The most common error was to release the grant over two years rather than three.

(2) Sale and operating leaseback: Answers to this were more mixed although a good majority of candidates did identify this as an operating leaseback and justified their decision using the information given in the scenario. Again most candidates realised that the fact that selling price was above fair value should have an impact on the amount and timing of the profit to be recognised. A pleasing number of candidates calculated the figures for the release of the deferred profit correctly reflecting the fact that the transaction took place three months into the year. However a number of candidates either suggested deferring the entire profit on disposal or mixed up the amount to be recognised immediately with the amount to be deferred.

A minority of candidates decided that the transaction was a finance leaseback/secured loan despite the fact that they often also referred to the short period of the leaseback. Other candidates discussed the risks and rewards of ownership but made a conclusion the wrong way round.

(3) Held for sale assets: This was probably the issue that was answered the least well by candidates with answers being quite mixed although pleasingly most candidates did identify the key issue – here non-current assets held for sale with a significant number also realising that only one of the assets met the relevant criteria. Again most candidates did refer to the criteria but to gain full marks candidates needed to apply the criteria to the scenario rather than just list them out. Having correctly identified the asset held for sale most candidates recognised that depreciation should have stopped and many calculated the correct adjustment to the depreciation charge for the year (although some failed to pro rate it for the correct number of months). Although most candidates realised that the asset needed to be transferred to non - current assets held for sale a significant number did this at the higher (rather than lower) of fair value less costs to sell and carrying amount. Many candidates seemed confused as to the different approaches for assets carried at cost (as was the case here) and those carried at revalued amount and therefore incorrectly recognised a revaluation surplus.

With regard to the asset that did not meet the criteria answers were disappointing with relatively few candidates recognising that a “normal” IAS 36 impairment test was required comparing carrying amount to recoverable amount. Even where this was discussed relatively few candidates managed to calculate the impairment correctly. Even fewer then realised that the write down to recoverable amount should have reduced the subsequent depreciation charge and it was very unusual to see this amount calculated correctly.

A number of candidates wasted time by not reading the question carefully and in particular not recognising that the carrying amounts given were as at the time of the decision to close the manufacturing operations. Therefore they produced lengthy calculations to arrive at the carrying amount already given. Other candidates also seemed unsure as to whether depreciation for the year had already been charged although this was clearly stated in the question. A significant minority of candidates also treated the two separate operations as needing to be treated as one, so because Dirac did not meet the criteria neither could be.

(4) Treasury shares: Generally this was reasonably well answered with nearly all candidates correctly recognising that these shares were treasury shares and that they should have been debited to equity rather than investments. Most candidates also calculated the correct amount. A minority of candidates calculated the amount using the nominal value of the shares only and/or seemed to think that the correct double entry was to debit share capital/share premium rather than a separate reserve. A significant number of answers were quite brief and therefore candidates lost some easy marks from saying for example, that there was no impact on share capital and premium.

Total possible marks	34
Maximum full marks	23

(b)

	Profit before tax		Equity
	£	£	£
Draft		1,460,000	2,600,180
(1) Deferred income	(250,000)		
(2) Deferred profit	(700,000)		
(2) Release of profit in year	105,000		
(3) Reversal of depreciation - Ostwald	15,250		
(3) Impairment – Dirac	(164,997)		
(3) Reversal of excess depreciation – Dirac	2,619		
(4) Treasury shares	–		(210,000)
		(992,128)	(992,128)
		467,872	1,398,052

Answers to part (b) were very mixed and a significant minority of candidates did not attempt this part of the question at all. For those who did, it was normally relatively easy to follow the adjustments relating to issues (1) and (4) but often difficult to see an audit trail for adjustments relating to issues (2) and (3). Candidates frequently put the adjustments in the wrong way round (ie added rather than subtracted and vice versa) and relatively few reflected the impact on equity for the cumulative adjustments made to profit. A small minority thought that the requirement was to calculate earnings per shares!

Total possible marks	4
Maximum full marks	3

Question 3

Total Marks:

General comments
This was a mixed topic question with three distinct elements. Part (a) covered the preparation of extracts from a consolidated statement of cash flows. Part (b) required a revised extract for consolidated gross profit and part (c) required a discussion of the ethical issues arising from a request to prepare a paper on financing opportunities.

(a)

Consolidated statement of cash flows for year ended 31 March 2015 (extract)

Cash flows from investing activities		
Acquisition of subsidiary (135,000 – 3,150)	(131,850)	
Dividend received from associate (W1)	20,080	
Net cash used in investing activities		(111,770)
Cash flows from financing activities		
Proceeds from issue of ordinary shares (W2)	87,750	
Dividends paid to non-controlling interest (W3)	(41,065)	
Net cash used in financing activities		46,685

Workings

Draft cash flows from operating activities	£	£
Per question	386,480	
Decrease in trade receivables ((112,400 – 61,400) – 83,100)	32,100	
Increase in trade payables ((96,700 – 36,700) – 53,840)	6,160	
Revised cash flows from operating activities		424,740

(1) Associate

	£		£
B/d	176,300	Dividend received (β)	20,080
Share of profit	83,200	C/d	239,420
	259,500		259,500

(2) Share capital and premium

	£		£
		B/d (460,000 + 320,000)	780,000
		Non-cash issue (70,000 x £1.90)	133,000
C/d (575,000 + 425,750)	1,000,750	Cash received (β)	87,750
	1,000,750		1,000,750

(3) Non-controlling interest

	£		£
Cash (β)	41,065	B/d	246,700
		Acquisition (420,550 x 30%)	126,165
C/d	471,400	CPorL	139,600
	512,465		512,465

Generally candidates made a good attempt at this part of the question with many achieving full marks. Candidates generally made some attempt at presenting reasonable extracts from the consolidated statement of cash flows, although only a minority went as far as including sub-totals. Most candidates calculated proceeds from the share issue, although the number of candidates who adjusted the opening and closing balances for the non-cash issue were significantly lower.

The dividend received from the associate was generally calculated correctly although candidates often showed this in the incorrect place in the statement. The calculation of the cash outflow from the acquisition of the subsidiary was disappointing with candidates preparing an extensive calculation when the cash consideration was simply given in the question. A number of candidates correctly calculated the dividend paid to the non-controlling interest although it was common for it to be shown as an inflow, under investing activities or no adjustment made for the acquisition during the year.

A significant number of candidates correctly calculated the cash flows from operating activities, although the most common error was to add the newly acquired subsidiary's amounts rather than deducting them.

Total possible marks	8
Maximum full marks	7

(b)

Consolidated statement of profit or loss for year ended 31 March 2015

	£
Revenue	2,879,950
Cost of sales	(1,578,850)
Gross profit	1,301,100

Workings

(1) Consolidation schedule

	Fermi Group	7/12 Seyle Ltd	Adj	Consol
	£	£	£	£
Revenue	2,345,800	561,750	(27,600)	2,879,950
Cost of sales – per Q	(1,290,200)	(313,250)	27,600	(1,578,850)
– PURP – Sub (W2)	(2,300)			
– PURP – Associate (W2)	(700)			

(2) PURP

	%	£	£
SP	120	27,600	24,000
Cost	(100)	(23,000)	(20,000)
GP	20	4,600	4,000
X $^1/_2$		2,300	2,000

Boas Ltd £2,000 x 35% = £700

Again many candidates achieved full marks for this part of the question, with candidates generally even completing the revised extract with full narrative and a total, which gained presentation marks. Most candidates managed to calculate the unrealised profits figures, although not all went on to apportion by 35% for the inter-company sale to the associate. However, how the unrealised profits were then adjusted was more mixed, with a significant number of candidates adjusting revenue as well as other candidates subtracting from the cost of sales figure rather increasing it.

Other common errors included not adjusting the subsidiary by seven months, or pro-rating it by the incorrect number of months and failing to adjust for intra-group sales and purchases when calculating consolidated totals.

Total possible marks	5½
Maximum full marks	5

(c) Ethical issues

Relevant key fundamental principles:

Professional competence and due care – Elion should consider whether he has the necessary skills and experience to prepare such a proposal and deliver it to the board. If Elion concludes he does not possess such skills and experience he could request to attend a training course to gain such expertise.

Even if he attends such a course will he still be able to gain the experience in time? It may be possible for Elion to instead assist another member of staff who does have the relevant experience. This would allow Elion to enhance his own skills and level of technical competence.

Professional behaviour – How should Elion proceed so as not to discredit himself in any way? Producing a paper without the relevant knowledge could lead to the board relying on such information and making an inappropriate investment decision.

Objectivity – Elion should remain objective at all times and not allow a possible self-interest threat to affect his professional judgement. Elion may want to impress the finance director and therefore may be tempted to try and prepare the paper.

Integrity – the integrity of the finance director should be questioned as he would be expected to have some idea as to the level of experience that Elion has had and therefore you'd expect him to make the judgement that he doesn't have the right level of expertise at this point in time.

Elion could take the following actions:

- He should speak to you as his senior in the first instance and see if you can come to an arrangement which will deliver the paper to the required standard.
- If Elion is not happy with your advice then he should speak directly with the finance director and discuss the different options available and the suggested courses of action, for example assisting another more experienced member of staff.
- If he still feels uncomfortable with the level of work he is being asked to prepare then speak to another director or human resources.
- Finally, if Elion is still unable to resolve the situation to his satisfaction then he should contact the ICAEW Ethical Helpline for advice.
- Elion should keep a detailed record of all discussions and the outcomes at each stage.

Most candidates prepared a reasonable answer with enough content to score at least half marks. The better candidates dissected the answer looking at different key elements of the ethical code, such as professional competence and due care, and professional behaviour. Weaker candidates produced generic answers that encompassed a broad range of relevant and non-relevant comments in relation to the scenario.

Total possible marks Maximum full marks	8 4

Question 4

Total Marks:

General comments
This question involved the preparation of a consolidated statement of financial position from individual company financial statements. The question included the acquisition of a subsidiary in the period, with a fair value adjustment and deferred consideration, along with an investment in a newly formed joint venture. Part (b) included an explanation and calculation of distributable profits for the parent entity.

(a) Huygens plc

(a) Consolidated statement of financial position as at 31 March 2015

	£	£
Assets		
Non-current assets		
Property, plant and equipment (911,700 + 89,400 + 15,000 – 750)		1,015,350
Intangibles (W2)		47,000
Investments (116,250 – 85,000 (W2) – 25,000 + 3,750 (W4))		10,000
Investment in joint venture (W6)		28,810
		1,101,160
Current assets		
Inventories (43,700 + 32,000 – 1,440 (W5)	74,260	
Trade and other receivables (71,000 + 17,900 – 12,800)	76,100	
Cash and cash equivalents (5,600 + 3,100 + 6,400)	15,100	
		165,460
Total assets		1,266,620
Equity and liabilities		
Equity attributable to owners of Huygens plc		
Ordinary share capital		300,000
Share premium account		105,000
Retained earnings (W4)		599,018
		1,004,018
Non-controlling interest (W3)		29,202
Total equity		1,033,220
Current liabilities		
Trade and other payables (98,600 + 21,400 – 6,400)	113,600	
Deferred consideration (40,000 + 1,000) (W4)	41,000	
Taxation (65,000 + 13,800)	78,800	
		233,400
Total equity and liabilities		1,266,620

Workings

(1) Net assets – Planck Ltd

	Year end	Acquisition	Post acq
	£	£	£
Share capital	50,000	50,000	
Retained earnings			
Per Question	57,200	39,000	
Less: PURP (W5)	(1,440)	–	
Fair value adjustment	15,000	15,000	
Depreciation thereon ((15,000 / 10) x 6/12)	(750)	–	
	120,010	104,000	16,010

(2) Goodwill – Planck Ltd

	£
Consideration transferred (85,000 + (42,000/1.05))	125,000
Non-controlling interest at acquisition – FV	26,000
Net assets at acquisition (W1)	(104,000)
	47,000

(3) Non-controlling interest – Planck Ltd

	£
NCI at acquisition date (W2)	26,000
Share of post-acquisition reserves (16,010 (W2) x 20%)	3,202
	29,202

(4) Retained earnings

	£
Huygens plc	579,650
Deferred consideration – unwinding (40,000 x 5% x 6/12)	(1,000)
Planck Ltd (16,010 (W1) x 80%)	12,808
Quimby Ltd (W6)	3,810
Quimby Ltd's dividend (15,000 x 25%)	3,750
	599,018

(5) Inventory PURP

	%	£
SP	100	9,600
Cost	(85)	(8,160)
GP	15	1,440

(6) Investments in Joint Venture – Quimby Ltd

	£
Cost	25,000
Add: Share of post acquisition profits (15,240 x 25%)	3,810
	28,810

Candidates made a reasonable attempt at this question with almost all candidates producing a relatively well laid out consolidated statement of financial position. As mentioned earlier in the examination commentary candidates did lose marks where there was no audit trail as to how a figure on the face of the statement had been arrived at. Where there are no workings candidates gain no marks unless the correct figure is arrived at. Most candidates gained all the marks for adding the parent and subsidiary's figures together, although a small minority pro-rated the subsidiary's figures to reflect that it was acquired during the year.

Share capital and premium were almost always correct and the separately presented non-controlling interest was almost always present, although candidates do not seem to understand the significance of the sub-total before and after this figure. A significant number of candidates showed a deferred consideration figure although not always the correct figure was shown, the most common error again was to not pro-rate this figure. Pleasingly a number of candidates also then adjusted retained earnings for the unwinding of this deferred amount.

It was pleasing to see that most candidates prepared a net assets table for Planck Ltd and that this was often completely correct. The most common error was to miscalculate the depreciation on the fair value adjustment, forgetting that it needed to be time apportioned. A significant number of candidates correctly calculated goodwill and the inventory PURP figure. The calculations for non-controlling interest and retained earnings were more mixed, although almost all candidates picked up some marks on these calculations.

Adjustments to the figures on the face of the consolidated statement of financial position were generally mixed, although completely correct figures were prepared by a number of candidates. The most common errors were to only deduct half of the inter-company invoice from trade receivables and not to adjust the cash figure for the cash in transit. Consolidated retained earnings were only completely correct in a minority of cases with candidates generally confused over the treatment of the PURP and dividend.

The figure which caused a problem to a majority of candidates was the calculation of the investment figure. A variety of calculations were presented, for example adding rather than subtracting the cost of investments and adding in the total dividend paid by Quimby Ltd rather than only Huygens plc's share.

Total possible marks	19
Maximum full marks	18

(b) Distributable profits

For entities within a group, distributable profits must be made for each individual entity, rather than the consolidated group. Therefore, Huygens plc's distributable profits are those profits distributable by the parent company only.

The basic rule is that distributable profits are measured as accumulated realised profits less accumulated realised losses, this is usually retained earnings of the individual company.

In the case of listed companies, here it is not clear whether Huygens plc is listed or not, the amount of distributable profits is further reduced by any excess of unrealised losses over unrealised profits. No such information is available in this question to determine this.

Huygens plc's distributable profits are therefore calculated as:

- The share of profits in the joint venture only affects the consolidated retained earnings, but Huygens plc's own financial statements would include the dividend from Quimby Ltd of £3,750. This should have been recognised in the Huygens plc's own statement of profit or loss, however was incorrectly deducted from Investments, thereby increasing retained earnings by £3,750.

- The finance cost arising on the deferred consideration will be recognised by Huygens plc and therefore reduces retained earnings by £1,000.

Huygens plc's distributable reserves are therefore £579,650 + 3,750 – 1,000 = £582,400.

This requirement was quite poorly answered by a majority of candidates. Most candidates didn't go beyond mentioning the basic rule, that distributable profits are calculated on an individual company basis and that it is often simply retained earnings. However, a small minority of candidates did go on to make an adjustment for the joint venture dividend and the unwinding of the deferred consideration.

Total possible marks	6½
Maximum full marks	3