IFRS

Theoretical Q & A

By

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(c) On 1 April 2012, the directors of Delta formed a new company, Epsilon. The directors of Delta own all the voting shares in Epsilon. In exercising their votes, the directors of Delta have agreed to act in Delta's best interests. Epsilon leased an asset from a financial institution and correctly classified this lease as a finance lease. Epsilon immediately leased the asset to Delta on a one year lease. The rentals payable by Delta to Epsilon were set at the same amount as the rentals payable by Epsilon to the financial institution. The terms of the lease from Epsilon to Delta gave Delta the option to extend the lease under exactly the same terms. This extension option will continue to be available on an annual basis until the lease between Epsilon and the financial institution expires. The asset is a vital one in Delta's production process. Epsilon does not undertake any other transactions.

(6 marks)

	Marks
(c) Under the principles of IFRS 10 – *Consolidated Financial Statements* – Delta has control over Epsilon. This is because:	1
The purpose of setting up Epsilon is to enable Delta to achieve a specific purpose.	½
Epsilon's dependence on Delta indicates that Delta has effective power over Epsilon.	1
The directors of Delta are acting as *de facto* agents of Delta in terms of their shareholdings in Epsilon.	½
Delta is exposed to variable returns (on the leased asset) which Delta has the power to affect through its use.	1
Therefore Delta will consolidate Epsilon and the leased asset and associated liability will be included in the consolidated financial statements as a finance lease.	1
The rental payments between Delta and Epsilon will be eliminated as an intra-group transaction.	1
	6
	20

4 You are the financial controller of Omega, a listed company which prepares consolidated financial statements in accordance with International Financial Reporting Standards (IFRS). Your managing director, who is not an accountant, has recently attended a seminar and has prepared a number of questions for you concerning two issues raised at the seminar:

(a) 'I was confused regarding a number of references to fair value and a new accounting standard on the subject. I thought financial statements were prepared on a historical cost basis. Please give me three examples of where fair value might be relevant for us. I was told the new standard removed an inconsistency in the definition of fair value and applied three levels of input into the measurement of fair value. Please explain how the new standard defines fair value and what the previous inconsistency was. Please also explain each level of input and how each level is applied in measuring the fair value of a particular item in the financial statements.' (10 marks)

(b) 'One of the topics discussed at the seminar was segment reporting. I believe I heard someone say that segment reporting varies from company to company depending on its internal structure. Please explain how we should identify the segments we use to provide our segment reporting information. I do not need to know the detailed content of a segment report.' (10 marks)

Required:

Provide answers to the questions raised by the managing director.

Note: The mark allocation is shown against each of the two issues above.

(20 marks)

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4 (a) Although it is true that the majority of assets and liabilities that are recognised in financial statements are measured based on their original cost, there are a number that are measured at fair value. Three examples of the use of the 'fair value basis' are:

The assets and liabilities of a newly acquired subsidiary are measured in the consolidated financial statements at their fair values at the date of acquisition. 1

Many financial instruments are measured at fair value. 1

Property, plant and equipment can be measured at fair value on a class by class basis. 1

(**Tutorial note:** *Other valid examples – e.g. investment properties or biological assets – would also receive credit.*)

IFRS 13 – *Fair Value Measurement* – defines fair value as the amount that would be **received to sell an asset**, or **paid to transfer a liability**, in an **orderly transaction** between **market participants**. ½ + ½ + ½ + ½

The IFRS 13 definition removes the uncertainty that was previously an issue in that it confirms that fair value is an exit measure, not an entry measure. ½

The fair value hierarchy refers to three levels of input into the measurement of fair value. These three levels vary in their reliability, starting with the most reliable and ending with the least reliable:

Level 1 inputs are market prices where the asset or liability is quoted in an active market. These inputs are given the highest priority when measuring fair values and are not normally subject to any adjustment. An example would be the use of quoted prices to measure the fair value of equity instruments. 1½

Level 2 inputs are inputs into the calculation of fair value that, whilst not market values, are observable to an external user. An example would be the quoted prices of shares in similar entities when measuring the fair value of an unquoted share. Level 2 inputs are sometimes adjusted to reflect differential circumstances. 1½

Level 3 inputs are those that are not observable to an external user. An example would be the assumptions regarding future profits when measuring the fair value of an unquoted share. When measuring fair values, use of Level 3 inputs should be kept to a minimum. 1½

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	Marks
(b) A reportable segment is an operating segment that satisfies certain materiality criteria.	½
An operating segment is a component of an entity:	
That engages in **business activities** from which it may **earn revenues and incur expenses**.	½ + ½
Whose operating results are **regularly reviewed** by the **Chief Operating Decision Maker** (CODM).	½ + ½
For which discrete financial information is available.	½
The CODM is a **function**, not a title. The function is to make decisions about **allocating resources** and **assessing performance**.	½ + ½ + ½
The materiality criteria are **any one** of the following:	½
Reported revenue is 10% or more of the total revenue of all operating segments.	½
The **absolute amount of its reported profit or loss** is 10% or more of the greater of the **combined reported profit** of all the profit making segments and the **combined reported loss** of all the segments that reported a loss.	½ + ½ + ½
Total assets are 10% or more of the total assets of all operating segments.	½
Two or more operating segments that exhibit **similar economic characteristics** can be combined into a **single operating segment** for reporting purposes.	½ + ½
Even if an operating segment does not meet any of the quantitative thresholds, it can be considered reportable if management believes that information about that segment would be useful to users of the financial statements.	½
As a minimum, the total external revenue of reportable segments should be at least 75% of total entity revenue. If this is not achieved by applying the size criteria to individual segments, **additional reportable segments need to be added until this threshold is achieved**.	½ + ½
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June 2014

4 You are the financial controller of Omega, a listed company which prepares consolidated financial statements in accordance with International Financial Reporting Standards (IFRS). The year end of Omega is 31 March and its functional currency is the $. Your managing director, who is not an accountant, has recently prepared a list of questions for you concerning current issues relevant to Omega:

(a) One of my fellow directors has informed me that on 1 January 2014 his spouse acquired a controlling interest in one of our major suppliers, Sigma. He seemed to think that this would have implications for our financial statements. I cannot understand why. Our purchases from Sigma were $1·5 million for each month of our year ended 31 March 2014 and I acknowledge this is a significant amount for us. However, I can't see how the share purchase on 1 January 2014 affects **our** financial statements – all the purchases from Sigma were made at normal market rates, so what's the issue? Please explain this to me and identify any impact on our financial statements. (7 marks)

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4 (a) From 1 January 2014, Sigma would be regarded as a related party of Omega under IAS 24 – *Related Party Disclosures*.	1
This is because Sigma is **controlled** by the **close family member** of one of Omega's **key management personnel**.	½ + ½ + ½
This means that, **from 1 January 2014**, the purchases from Sigma would be regarded as **related party transactions**.	1
Transactions with related parties need to be **disclosed in the notes** to the financial statements, together with the **nature of the relationship**. It is **irrelevant** whether or not these transactions are at normal market rates.	½ + ½ + ½
The disclosures would state that a company controlled by the spouse of a director supplied goods to the value of **$4·5 million** (3 x $1·5 million) in the current accounting period. It would **not** be necessary to name the company.	1 + 1
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(b) You will be aware that we intend to open a new retail store in a new location in the next few weeks. As you know, we have spent a substantial sum on a series of television advertisements to promote this new store. We paid for advertisements costing $800,000 before 31 March 2014. $700,000 of this sum relates to advertisements shown before 31 March 2014 and $100,000 to advertisements shown in April 2014. Since 31 March 2014, we have paid for further advertisements costing $400,000. I was chatting to a colleague over lunch and she told me she thought **all** these costs should be written off as expenses in the year to 31 March 2014. I don't want a charge of $1·2 million against my 2014 profits! Surely these costs can be carried forward as intangible assets? After all, our market research indicates that this new store is likely to be highly successful. Please explain and justify the treatment of these costs of $1·2 million in the financial statements for the year ended 31 March 2014. (6 marks)

(b) **Under IAS 38** – *Intangible Assets* – intangible assets can only be recognised if they are **identifiable** and have a **cost** which can be reliably measured.	½ + ½ + ½
These criteria are very difficult to satisfy for **internally developed** intangibles.	½
For these reasons, IAS 38 specifically prohibits recognising advertising expenditure as an intangible asset.	1
The issue of how successful the store is likely to be does not affect this prohibition.	½
Therefore your colleague is correct in principle that such costs should be recognised as expenses.	½
However, the costs would be recognised on an accruals basis.	½
Therefore, of the advertisements paid for before 31 March 2014, **$700,000** would be recognised as an expense and $100,000 as a pre-payment in the year ended 31 March 2014.	1
The $400,000 cost of advertisements paid for since 31 March 2014 would be charged as expenses in the year ended 31 March 2015.	½
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(c) As you know, on 1 January 2014 we purchased a machine for 2 million kroner. At that date the exchange rate was $1= 10 kroner. We don't have to pay for this purchase until 30 June 2014. The kroner strengthened against the $ in the three months following purchase and by 31 March 2014 the exchange rate was $1 = 8 kroner. I thought these exchange fluctuations wouldn't affect our financial statements because we have an asset and a liability denominated in kroner which was initially the same amount. We're depreciating this machine over four years so the future year-end amounts won't be the same, of course. Something I heard at a seminar, but didn't really grasp, made me think I could be mistaken. Please explain the impact of this transaction on our financial statements for the year ended 31 March 2014. (7 marks)

(c) Under the principles of IAS 21 – *Foreign Currency Transactions* – the asset and liability would **initially** be recognised at the rate of exchange in force at the **transaction date** – 1 January 2014. Therefore the amount initially recognised would be **$200,000** (2 million kroner x 1/10).	½ + ½ + ½
The liability is a **monetary item** so it is retranslated using the rate of exchange in force at **31 March 2014**. This makes the closing liability **$250,000** (2 million kroner x 1/8).	½ + ½ + ½
The loss on re-translation of **$50,000** ($250,000 – $200,000) is recognised in the **statement of profit or loss**.	½ + ½
The machine is a **non-monetary** asset carried at **historical cost**. Therefore it continues to be translated using the rate of **10** kroner to $1.	½ + ½ + ½
Depreciation of **$12,500** ($200,000 x ¼ x 3/12) would be charged to **profit or loss** for the year ended 31 March 2014.	½ + ½
The closing balance in property, plant and equipment would be $187,500 ($200,000 – $12,500). This would be shown as a non-current asset in the statement of financial position.	½
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Dec 2014

4 You are the financial controller of Omega, a listed entity which prepares consolidated financial statements in accordance with International Financial Reporting Standards (IFRS). The managing director, who is not an accountant, has recently been appointed. She formerly worked for Rival, one of Omega's key competitors. She has reviewed the financial statements of Omega for the year ended 30 September 2014 and has prepared a series of queries relating to those statements:

Query One

'I was very confused by the note that included financial information relating to our operating segments. This note bears very little resemblance to the equivalent note included in the financial statements of Rival. Please explain how the two notes can be so different.' (8 marks)

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4 Query One

It is true that the there is an International Financial Reporting Standard (IFRS) which deals with operating segments and lays down the content of segmental reports (**concept**). The relevant standard is IFRS 8 – *Operating Segments*.	½
However, differences between the segment reports of organisations will arise from how segments are identified and what exactly is reported for each segment (**concept**).	½ + ½
IFRS 8 defines an operating segment as a component of an entity which engages in **revenue earning** activities and whose results are regularly reviewed by the **chief operating decision maker (CODM)**.	½ + ½
The CODM is the **individual**, **or group of individuals**, who makes decisions about **segment performance** and **resource allocation**.	½ + ½ + ½
This definition means that the operating segments of apparently similar organisations could be identified very differently, with a consequential impact on the nature of the report.	½
As stated above, differences also arise due to the reporting requirements for each segment. IFRS 8 requires that **'a measure' of profit or loss** is reported for each segment. However, the **measurement of revenues and expenses which are used in determining profit or loss is based on the principles used in the information the CODM sees**. This is so, **even if these principles do not correspond with IFRS**. This could **clearly cause differences** between reports from apparently similar organisations.	½ + ½ + ½ + ½
Additionally, IFRS 8 requires a measure of total **assets** and **liabilities** by operating segment if the **CODM sees this information**. Since **some CODMs may see this information and some may not**, this could once again cause differences between the reports of apparently similar organisations.	½ + ½ + ½
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Query Two

'The notes to our financial statements refer to equity settled share-based payments relating to the granting of share options. When I joined Omega, I was granted share options but I can only exercise those options if I achieve certain performance targets in my first three years as managing director. I know that other directors are also granted similar option arrangements. I don't see why they affect the financial statements when the options are granted though, because no cash is involved unless the options are exercised. Please explain to me exactly what is meant by an 'equity settled share-based payment'. Please also explain how, and when, equity settled share-based payments affect the financial statements of entities that grant them to their employees. I would like to know how such 'payments' are measured, over what period the 'payments' are recognised, and exactly what accounting entries are involved.'

(8 marks)

Query Two

An equity settled share-based payment transaction is one in which an entity receives goods or services in exchange for a right over its equity instruments. ½

Where the payments involve the granting of share options, IFRS 2 – *Share-based Payment* – requires that the payments are measured at the **fair value** of the options at the **grant date**. No change is made to this measurement when the fair value **changes after the grant date**. ½ + ½ + ½

Unless the entity has traded options which have exactly the same terms and conditions as those granted to employees (unlikely), then fair value is estimated using an option pricing model. ½

The first step in accounting for such payments is to estimate the total expected cost of the share-based payment. ½

This estimate takes account of any **conditions** attaching to the options vesting (**the employees becoming unconditionally entitled to exercise them**) other than **market** conditions (those based on the future share price, which are taken account of in estimating the fair value of the option at the grant date). ½ + ½ + ½

The total expected cost is recognised in the financial statements over the vesting period (i.e. the period from the grant date to the vesting date). ½

In the case of options granted to employees, the debit entry would be recorded as **remuneration expense**. Normally this would mean the debit entry being shown in the statement of **profit or loss** but in theory the debit entry could be an asset depending on the work of the employee involved. ½ + ½

The credit entry is taken to **equity**. IFRS 2 is **silent** as to which component of equity this should be – normally it would be to an option reserve. ½ + ½

The above treatment is **unaffected** by whether or not employees subsequently exercise vested options. **If they do**, then the entity debits cash and credits equity with the cash proceeds. ½ + ½

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Query Three

'I was confused when I looked at the statement of financial position and saw that the assets and liabilities were divided up into three sections and not two. The current and non-current sections I understand but I don't understand the 'non-current assets held for sale' and 'liabilities directly associated with non-current assets held for sale' sections. Please explain the meaning and accounting treatment of a non-current asset held for sale. Please also explain how there can be liabilities directly associated with non-current assets held for sale.' (4 marks)

Required:

Provide answers to the three queries raised by the managing director. Your answers should refer to relevant provisions of International Financial Reporting Standards

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Query Three

A non-current asset is classified as held for sale when its carrying amount will be recovered principally through a sale transaction, rather than through continuing use.	1
Such assets are measured at the lower of their **carrying amount** and **fair value less costs to sell**. Any write downs arising out of this process are treated as **impairment losses**.	½ + ½ + ½
The 'held for sale' definition can apply to **groups of assets** as well as single assets where the group of assets is to be sold as a **single unit**. It is in situations **such as this** that liabilities associated with such groups of assets are separately identified.	½ + ½ + ½
	4

June 2015

4 You are the financial controller of Omega, a listed company which prepares consolidated financial statements in accordance with International Financial Reporting Standards (IFRS). Your managing director, who is not an accountant, has recently attended a seminar and has the following questions for you concerning issues raised at the seminar:

(a) One of the delegates at the seminar was a director of an entity which operates a number of different farms. She informed me that there was a financial reporting standard which applied to farming entities. I think she said it was IAS 41. I'd like to know why a special standard is needed for farming entities. Given that we have IAS 41, does this mean that other IFRSs do not apply to farming entities? Please explain the main recognition and measurement requirements of IAS 41 – I'm not interested in details about disclosures. I am interested, though, in any areas where the provisions of IAS 41 differ from general IFRSs. I believe I heard that farming entities treat grants from the government in a different way than other entities do. I'm particularly interested to hear about this – assuming I'm correct. (12 marks)

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4 **(a)** It is not true that, given the existence of IAS 41 – *Agriculture* – other IFRSs do not apply to farming companies. The general presentation requirements of IAS 1 – *Presentation of Financial Statements*, together with the specific recognition and measurement requirements of other IFRSs, apply to farming companies just as much as others. 1

IAS 41 deals with **agricultural activity**. Two key definitions given in IAS 41 are **biological assets** and **agricultural produce**. ½ + ½ + ½

A biological asset is a living animal or plant. Examples of biological assets would be sheep and fruit trees. 1

The criteria for the recognition of biological assets are basically consistent with other IFRSs, and are based around the Framework definition of an asset. 1

A key issue dealt with in IAS 41 is that of **measurement** of biological assets. Given their **nature** (e.g. lambs born to sheep which are existing assets, the use of **cost** as a measurement basis is impracticable. ½ + ½

The IAS 41 requirement for biological assets is to measure them at **fair value** less **costs to sell**. ½ + ½

Changes in fair value less costs to sell from one period to another are recognised in profit or loss. ½

Agricultural produce is the harvested produce of a biological asset. Examples would be wool (from sheep) or fruit (from fruit trees). 1

The issue of measuring 'cost' of such assets is **similar** to that for biological assets. IAS 41 therefore requires that 'cost' should be **fair value less costs to sell** at the point of harvesting. This figure is then the **deemed 'cost'** for the purposes of IAS 2 – *Inventories*. ½ + ½ + ½

A consequence of the above treatment is that government grants receivable in respect of biological assets are **not** treated in the way prescribed by IAS 20 – *Government Grants*. Where such a grant is **unconditional**, it should be recognised in profit or loss when it becomes receivable. If conditions attach to the grant, it should be recognised in profit or loss only when the conditions have been met. ½ + ½ + ½

The IAS 20 treatment of grants is to recognise them in profit or loss as the expenditure to which they relate is recognised. This means that recognition of grants relating to property, plant and equipment takes place over the life of the asset rather than when the relevant conditions are satisfied. 1

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(b) Another delegate, a director of a relatively small listed entity, stated that his entity did not need to comply with the detailed requirements of IFRS because of the relatively small size of the entity. Is it true that there are different accounting rules which are available for smaller entities? Can his entity take advantage of them? Please give me an outline explanation – I don't need the details of any different rules. (8 marks)

Required:

Provide answers to the questions raised by the managing director.

Note: The mark allocation is shown against each of the two questions above.

(b) The International Accounting Standards Board has developed an **IFRS for small and medium sized entities (SMEs)** which can be used as an **alternative** to full IFRS.	½ + ½
Despite the title of the IFRS for SMEs it is **not** available for all small and medium sized entities. The standard can only be used by entities which are not **publicly accountable**. Therefore the standard could not be used by your colleague as the entity is **listed**.	½ + ½ + ½
The IFRS for SMEs is **one single standard** which, if adopted, is used **instead of all IFRS**.	½ + ½
The IFRS for SMEs omits completely the requirements of IFRS which are specifically relevant to **listed** entities, **for example**, earnings per share and segmental reporting.	½ + ½
In addition, the **subject matter** included in the IFRS for SMEs has been **simplified** compared with full IFRS. **For example**, research and development costs are always expensed and non-current assets are never revalued.	½ + ½ + ½
In general terms, the disclosures required by the IFRS for SMEs are considerably less burdensome than for full IFRS.	1
A further benefit is that the IFRS for SMEs is only updated once every three years, thus reducing the extent of change to financial reporting practice.	1
	8

Dec 2015

3 (a) IFRS 15 *Revenue from Contracts with Customers* was issued in 2014 and replaces the previous international financial reporting standard relating to revenue.

Required:

(i) Identify the five steps which need to be followed by entities when recognising revenue from contracts with a customer.

(ii) Explain how IFRS 15 is expected to improve the financial reporting of revenue. (5 marks)

3 (a) (i) The five steps to be followed are to:

Identify the contract(s) with the customer.	½
Identify the performance obligations the contract(s) create.	½
Determine the transaction price.	½
Allocate the transaction price to the separate performance obligations.	½
Recognise the revenue associated with each performance obligation as the performance obligation is satisfied.	½
(ii) The IASB issued IFRS 15 because the existing criteria for revenue recognition outlined in IASs 11 and 18 were considered to be very **subjective**. Therefore it was difficult to **verify the accuracy** of the reported figures for revenue and associated costs.	½ + ½
One of the fundamental qualitative characteristics of useful financial information which is referred to in the IASB Conceptual Framework is **faithful representation**. Information needs to be **verifiable** in order to ensure it meets this fundamental characteristic. IFRS 15 provides a more robust framework upon which to base the revenue recognition decision, thus increasing the verifiability of the revenue figure and hence its usefulness.	½ + ½ + ½
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4 You are the financial controller of Omega, a listed company which prepares consolidated financial statements in accordance with International Financial Reporting Standards (IFRS). Your managing director, who is not an accountant, has recently attended a seminar and has raised two questions for you concerning issues discussed at the seminar:

(a) One of the delegates at the seminar was a director of an entity which is involved in the exploration for, and evaluation of, mineral resources. This delegate told me that under IFRS rules it is possible for individual entities to develop their own policies for when to recognise the costs of exploration for and evaluation of mineral resources as assets. This seems very strange to me. Surely IFRS requires consistent treatment for all tangible and intangible assets so that financial statements are comparable. Please explain the position to me and outline the relevant requirements of IFRS regarding accounting for exploration and evaluation expenditures. (10 marks)

4 **(a)** Expenditure on the exploration for, and evaluation of, mineral resources is **excluded** from the scope of standards which might be expected to provide guidance in this area. Specifically such expenditure is not covered by **IAS 16** – *Property, Plant and Equipment* – or **IAS 38** – *Intangible Assets*. ½ + ½ + ½

This has meant that, in the absence of any alternative pronouncements, entities would determine their accounting policies for exploration and evaluation expenditures in accordance with the general requirements of **IAS 8** – *Accounting Policies, Changes in Accounting Estimates and Errors*. This could lead to considerable **divergence** of practice given the diversity of relevant requirements of **other** standard setting bodies. ½ + ½ + ½

Given other pressures on its time and resources, the International Accounting Standards Board (IASB) decided in 2002 that it was not able to develop a comprehensive standard in the immediate future. 1

However, recognising the importance of accounting for extractive industries generally the IASB issued IFRS 6 – *Exploration for and Evaluation of Mineral Resources* – to achieve some level of standardisation of practice in this area. 1

IFRS 6 requires relevant entities to **determine** a policy specifying which expenditures are recognised as exploration and evaluation assets and apply the policy **consistently**. ½ + ½

When recognising exploration and evaluation assets, entities shall consistently classify them as tangible or intangible according to their nature. 1

Subsequent to initial recognition, entities should consistently apply the cost model or the revaluation model to exploration and evaluation assets. 1

If the revaluation model is used, it should be applied according to IAS 16 (for tangible assets) or IAS 38 (for intangible assets). 1

Where circumstances suggest that the carrying amount of an exploration and evaluation asset may exceed its recoverable amount, such assets should be reviewed for impairment. Any impairment loss should basically be measured, presented and disclosed in accordance with IAS 36 – *Impairment of Assets*. 1

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(b) Another delegate was discussing the fact that the entity of which she is a director is relocating its head office staff to a more suitable site and intends to sell its existing head office building. Apparently the existing building was advertised for sale on 1 July 2015 and the entity anticipates selling it by 31 December 2015. The year end of the entity is 30 September 2015. The delegate stated that in certain circumstances buildings which are intended to be sold are treated differently from other buildings in the financial statements. Please outline under what circumstances buildings which are being sold are treated differently and also what that different treatment is.

(10 marks)

(b) The accounting treatment of buildings to be sold is governed by IFRS 5 – *Non-Current* **Assets** *Held for Sale and Discontinued Operations.* ½

A building would be classified as held for sale if its carrying amount will be recovered principally through a sale transaction, rather than through continuing use. ½

For this to be the case, the asset must be available for **immediate** sale in its **present** condition. Also management must be **committed** to a plan to sell the asset and an **active programme** to locate a buyer must have been initiated. Further, the asset must be **actively** marketed for sale at a **reasonable** price. In addition, the sale should be expected to be completed within **one year** of the date of classification as held for sale (although there are certain circumstances in which the one-year period can be **extended**). Finally it should be unlikely that significant **changes** to the plan will be made or that the plan will be **withdrawn**. ½ + ½ + ½ + ½ + ½ + ½ + ½ + ½ + ½ + ½

Immediately **prior** to being classified as held for sale, assets should be stated (or re-stated) at their **current** carrying amount under relevant International Financial Reporting Standards. Assets then classified as held for sale should be measured at the **lower** of their **current** carrying amount and their **fair value less costs to sell**. Any write down of the assets due to this process would be regarded as an **impairment** loss and treated in accordance with IAS 36 – *Impairment of Assets*. ½ + ½ + ½ + ½ + ½ + ½

Assets classified as held for sale should be presented separately from other assets in the statement of financial position 1

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June 2016

4 You are the financial controller of Omega, a listed entity which prepares consolidated financial statements in accordance with International Financial Reporting Standards (IFRS). The managing director, who is not an accountant, has recently attended a business seminar at which financial reporting issues were discussed. Following the seminar, she reviewed the financial statements of Omega for the year ended 31 March 2016. Based on this review she has prepared a series of queries relating to those statements:

Query One

'One of the issues discussed at the seminar was 'impairment of financial assets'. On reviewing our financial statements I have noticed that we have two types of financial assets – Type A (those measured at amortised cost) and Type B (those measured at 'fair value through profit or loss'). It appears we carry out impairment reviews of Type A assets but not Type B assets. Please explain to me why this is the case and also please explain exactly how an impairment review of Type A assets is carried out.' (8 marks)

4 Query One

A financial asset is impaired when its carrying amount cannot be reasonably expected to be recovered through future generation of income or sale proceeds.	1
(Note: Exact words NOT needed here, just the sense of the point.)	
IFRS 9 – *Financial Instruments* – classifies financial assets into three types. One of these types is 'fair value through profit and loss'. Where financial assets are measured on this basis, any impairment of the asset is automatically reflected in the measurement basis so no further action is required.	1
As far as other financial assets are concerned, the general rule is that we should recognise **a loss allowance** for 'expected credit losses'. The loss allowance should be recognised in **profit or loss** and **deducted from the carrying amount** of the financial asset in the statement of financial position.	½ + ½ + ½ + ½
A credit loss is the difference between the cash flows we are contractually entitled to receive in respect of a financial asset and the cash flows which are expected based on current circumstances.	1
Unless the credit risk attaching to the financial asset has increased significantly since initial recognition, the loss allowance should be based on expected credit losses in the next 12 months.	1
Where the credit risk has increased significantly since initial recognition, the loss allowance should be based on lifetime expected credit losses.	1
As far as trade receivables and (by choice) lease receivables are concerned, as a simplifying measure IFRS 9 allows the loss allowance to always be measured based on the lifetime expected credit losses.	1
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Query Two

'Another issue discussed at the seminar was financial reporting by farming entities. The issue of 'biological assets' was mentioned. I don't really understand what these are or how they're recognised and measured in the financial statements. Please explain this to me.' (5 marks)

Query Two

A biological asset is defined in IAS 41 – *Agriculture* – as a living plant or animal. 1

The majority of non-biological assets of an entity have an initial acquisition cost which can be computed with sufficient reliability to be used as its initial carrying value. For biological assets (e.g. a new born calf) this is often not the case. 1

(Note: Exact words NOT needed here, just the sense of the point.)

For the vast majority of biological assets their **initial** measurement should be at its **fair value less costs to sell**. Gains or losses arising from such initial measurement should be recognised in **profit or loss**. ½ + ½ + ½

As the biological **asset transforms and its fair value less costs to sell changes**, the carrying amount of the asset should be **updated** with changes being recognised in **profit or loss**. ½ + ½ + ½

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Query Three

'During a break-out session I heard someone talking about accounting policies and accounting estimates. He said that when there's a change of these items sometimes the change is made retrospectively and sometimes it's made prospectively. Please explain the difference between an accounting policy and an accounting estimate and give me an example of each. Please also explain the difference between retrospective and prospective adjustments and how this applies to accounting policies and accounting estimates.' (7 marks)

Required:

Provide answers to the three questions raised by the managing director. Your answers should refer to relevant provisions of International Financial Reporting Standards.

Query Three

IAS 8 – *Accounting Policies, Changes in Accounting Estimates and Errors* – defines an accounting policy as 'the specific principles, bases, conventions, rules and practices applied by an entity in preparing and presenting financial statements'. 1½

(Note: Exact words NOT needed here, just the sense of the point.)

An example of an accounting policy would be the decision to apply the cost model or the fair value model when measuring investment properties. 1

(Note: ANY reasonable example accepted.)

When an entity changes an accounting policy, the change is applied **retrospectively**. This means that the **comparative** figures are based on the new policy (rather than last year's actual figures). The **opening balance of retained earnings is restated** in the **statement of changes in equity**. ½ + ½ + ½ + ½

Accounting estimates are made in order to implement accounting policies. An example of an accounting estimate would be (consistent with the above given example) the fair value of an investment property at the reporting date (where the fair value model was being applied). 1½

(Note: ANY reasonable example accepted.)

Changes in accounting estimates are made **prospectively**. This means applying the new estimates in **future financial statement preparation**, without amending any previously published amounts. ½

(Note: Exact words NOT needed here, just the sense of the point.)

½

7

Dec 2016

4 You are the financial controller of Omega, a listed entity which prepares consolidated financial statements in accordance with International Financial Reporting Standards (IFRS). You have recently produced the final draft of the financial statements for the year ended 30 September 2016 and these are due to be published shortly. The managing director, who is not an accountant, reviewed these financial statements and prepared a list of queries arising out of the review.

Query One

One of the notes to the financial statements gives details of purchases made by Omega from entity X during the period. I own 100% of the shares in entity X but I do not understand why it is necessary for any disclosure whatsoever to be made in the Omega financial statements. The transaction is carried out on normal commercial terms and is totally insignificant to Omega, representing less than 1% of Omega's purchases. (5 marks)

4 Query One

The reason disclosure of this transaction is necessary is because entity X is a **related party** of Omega. Related parties are generally characterised by the presence of **control or influence** between the two parties. ½ + ½

IAS 24 – *Related Party Disclosures* – identifies related parties as, inter alia, **key management personnel** and **companies controlled by key management personnel**. On this basis, entity X is a related party of Omega. ½ + ½

Where related party relationships exist, IAS 24 requires the disclosure of the existence of the relationship where the related party controls the reporting entity. This is not the case here, so in the absence of transactions disclosure would not be required. 1

Where transactions occur with related parties, IAS 24 requires that details of the transactions are disclosed in a note to the financial statements. This is required even if the transactions are carried out on a normal arm's length basis. 1

Transactions with related parties are material by their nature, so the fact that the transaction may be numerically insignificant to Omega does not affect the need for disclosure. 1

5

Query Two

The notes to the financial statements say that plant and equipment is held under the 'cost model'. However, property which is owner occupied is revalued annually to fair value. Changes in fair value are sometimes reported in profit or loss but usually in 'other comprehensive income'. Also, the amount of depreciation charged on plant and equipment as a percentage of its carrying amount is much higher than for owner occupied property. Another note says that property we own but rent out to others is not depreciated at all but is revalued annually to fair value. Changes in value of these properties are always reported in profit or loss. I thought we had to be consistent in our treatment of items in the accounts. Please explain how all these treatments comply with relevant reporting standards. (7 marks)

Query Two

The accounting treatment of the majority of tangible non-current assets is governed by IAS 16 – *Property, Plant and Equipment* (PPE).	½
IAS 16 states that the accounting treatment of PPE is determined on a class by class basis. For this purpose, property and plant would be regarded as separate classes.	1
IAS 16 requires that PPE is measured using either the cost model or the revaluation model. This model is applied on a class by class basis and must be applied consistently within a class.	1
IAS 16 states that when the revaluation model applies, surpluses are recorded in other comprehensive income, unless they are cancelling out a deficit which has previously been reported in profit or loss, in which case it is reported in profit or loss.	1
Where the revaluation results in a deficit, then such deficits are reported in profit or loss, unless they are cancelling out a surplus which has previously been reported in other comprehensive income, in which case they are reported in other comprehensive income.	½
According to IAS 16, all assets having a **finite** useful life should be depreciated over that life. Where property is concerned, the only depreciable element of the property is the **buildings** element, since land normally has an indefinite life. The estimated useful life of a building tends to be much **longer** than for plant. These two reasons together explain why the depreciation charge of a property as a percentage of its carrying amount tends to be much lower than for plant.	½ + ½ + ½
Properties which are held for investment purposes are **not** accounted for under IAS 16, but under IAS 40 – *Investment Property*.	½
Under the principles of IAS 40, investment properties can be accounted for under a cost or a fair value model. We apply the fair value model and thus our investment properties are revalued annually to fair value, with any changes being reported in profit or loss.	1
	7

Query Three

As you know, in the year to September 2016 we spent considerable sums of money designing a new product. We spent the six months from October 2015 to March 2016 researching into the feasibility of the product. We charged these research costs to profit or loss. From April 2016, we were confident that the product would be commercially successful and we fully committed ourselves to financing its future development. We spent most of the rest of the year developing the product, which we will begin to sell in the next few months. These development costs have been recognised as intangible assets in our statement of financial position. How can this be right when all these research and development costs are design costs? Please justify this with reference to relevant reporting standards.

(5 marks)

	Marks
Query Three	
Accounting for product design costs is governed by IAS 38 – *Intangible Assets*.	½
Under IAS 38, the treatment of expenditure on intangible items depends on how it arose.	½
Generally internal expenditure on intangible items cannot be recognised as assets.	1
The exception to the above rule is that once it can be demonstrated that a development project is likely to be **technically feasible, commercially viable, overall profitable** and can be **adequately resourced**, then **future** expenditure on the project can be recognised as an **intangible** asset. This explains the differing treatment of expenditure up to 31 March 2016 and expenditure after that date.	½ + ½ + ½ ½ + ½+ ½
	5

Query Four

On reviewing our financial statements, I found a note giving information about the different segments of our business and also the disclosure of the earnings per share of our entity. Neither the segment note nor the earnings per share disclosure appears in the financial statements of entity X (see query 1 above). Even though entity X is unlisted, both entities report under full International Financial Reporting Standards so I do not understand how this difference can occur. Please explain this to me. (3 marks)

Query Four	
Where two companies report under the same reporting framework, you would **generally** expect the same reporting requirements to apply to both companies. However, there are certain requirements of IFRS which **apply to listed companies only**.	½ + ½
The requirement to provide segmental information and to disclose earnings per share are both examples of requirements which only listed companies are forced to comply with.	1
If an unlisted entity voluntarily chooses to provide segmental information, or to disclose its earnings per share, then it must comply with the provisions of the relevant IFRS in both cases.	1
	3

June 2017

4 You are the financial controller of Omega, a listed entity which prepares consolidated financial statements in accordance with International Financial Reporting Standards (IFRS). One of your assistants, a trainee accountant, is involved in the preparation of the consolidated financial statements for the year ended 31 March 2017. She is also involved in the preparation of the individual financial statements for the entities in the group. She has sent you an email with the following queries:

Query One

On 1 April 2016 we acquired a new subsidiary. This subsidiary has always prepared its financial statements in $ but has used IFRS for the first time this year. Previously, they have used local standards. This means that the comparative figures (they present comparatives for one year only), taken from last year's financial statements, will be based on local standards not IFRS. How do I make sure we are comparing like with like in the current year individual financial statements of the subsidiary? Please just give me the general procedure, rather than dealing with any specialised exemptions. (7 marks)

4 **Query One**

When an entity adopts International Financial Reporting Standards (IFRSs) for the first time, the entity needs to prepare an opening IFRS statement of financial position at the date of transition to IFRS. This is a requirement of IFRS 1 *First Time Adoption of International Financial Reporting Standards*. 1

The date of transition to IFRS is the beginning of the earliest period for which the entity provides comparative information. In our case, this date is 1 April 2015. 1

The opening IFRS statement of financial position should be prepared in accordance with IFRSs which are in force for the current reporting period – in this case, the year ended 31 March 2017. 1

The statement of profit or loss and other comprehensive income, and the statement of changes in equity, which are presented as comparative figures in the financial statements for the year ended 31 March 2017, shall also be prepared in accordance with IFRSs which are in force for the year ended 31 March 2017. 1

In the first set of financial statements we will need a reconciliation of those amounts which were previously reported under local standards in the previous year's financial statements. 1

The reconciliation will be between the amounts reported in previous periods under local standards and the equivalent amounts reported as comparatives in the current period under IFRSs. 1

For us, this will mean reconciling equity at 1 April 2015 and 31 March 2016, plus total comprehensive income for the year ended 31 March 2016. 1

7

Query Two

I notice that on 1 April 2016 we lent $50 million to a key supplier. The loan has an annual rate of interest of 5%, with interest of $2·5 million payable on 31 March each year in arrears. The loan is repayable on 31 March 2026 but I believe that if interest rates change, we might consider assigning the loan to a third party. As it turns out, interest rates have fallen since 1 April 2016 and the fair value of the loan asset at 31 March 2017 was $52 million. I have been told that this loan asset should be measured at 'fair value through other comprehensive income'. Why is this? I thought loan assets were measured at amortised cost. If the loan asset is measured at fair value through other comprehensive income, does the interest income get recorded in other comprehensive income rather than profit or loss? (6 marks)

Query Two

The measurement basis for financial assets is set out in IFRS 9 *Financial Instruments*. The measurement basis depends on the business model for managing the financial asset and the contractual cash flow characteristics of the financial asset. 1

In order for the financial asset to be measured at amortised cost, the contractual terms should give rise to cash flows on specified dates which are solely payments of principal and interest on the amounts outstanding. This condition is satisfied in the case of the loan you are querying. 1

There is, however, another condition to be satisfied. The asset should be held under a business model whose objective is to hold the financial asset in order to collect the contractual cash flows. This condition is not satisfied, given the possibility of assigning the loan should interest rates rise. 1

A financial asset is measured at fair value through other comprehensive income where the 'contractual cash flow test' is passed and the asset is held under a business model whose objective is achieved both by collecting the contractual cash flows and by selling the financial asset. This appears to be the case here, so classification as fair value through other comprehensive income seems appropriate. 1

Where a financial asset is measured at fair value through other comprehensive income, the interest income which is included in profit or loss is the same amount as would be recorded were the asset to be measured at amortised cost. Therefore interest income of $2·5 million will be recorded in profit or loss. 1

The increase in fair value of $2 million ($52 million – $50 million) will be recorded in other comprehensive income. 1

6

Query Three

I'm not sure whether we need to make any entries in respect of the equity settled share-based payment scheme we started on 1 April 2016. I believe we granted options to 1,000 employees to purchase 100 shares in Omega for a fixed price. The options vest on 31 March 2021 subject to two conditions. The first vesting condition is that the employees remain employed by Omega throughout the five-year period up to the date of vesting. Best estimates are that 900 of the 1,000 will stay for that period – only 25 left in the year ended 31 March 2017. The other condition is that the Omega share price on 31 March 2021 should be at least \$10. The share price on 31 March 2017 was only \$8·50 so it doesn't look like this condition is satisfied yet. I've also noticed that the fair value of one share option was \$1 on 1 April 2016, rising to \$1·05 on 31 March 2017. Do we need any accounting entries and, if so, what should they be? (7 marks)

Required:

Provide answers to the three queries raised by the trainee accountant. Your answers should refer to relevant provisions of International Financial Reporting Standards.

Query Three

Under the provisions of IFRS 2 *Share-based Payment*, this arrangement is an equity settled share-based payment.	1
IFRS 2 regulates the treatment of vesting conditions based on whether they are market based or non-market based.	1
A market based vesting condition is taken into account by reflecting it in the measurement of the fair value of the option. It does not need to be considered subsequently as to do so would result in double-counting. Therefore the condition relating to the share price can be ignored after the fair value of \$1 is determined.	1
A non-market condition is taken into account by reflecting it in the calculation of the number of options ultimately expected to vest. In this case, that number would be 90,000 (900 x 100).	1
The cost of the arrangement is recognised over the vesting period, based on the fair value of the option at the grant date.	1
The amount recognised for the year ended 31 March 2017 would be \$18,000 (90,000 x \$1 x 1/5).	1
This amount is recognised as an employment cost (probably in profit or loss) and a corresponding credit to equity.	1
	7

Dec 2017

4 You are the financial controller of Omega, a listed entity which prepares consolidated financial statements in accordance with International Financial Reporting Standards (IFRS). You have recently prepared the financial statements for the year ended 30 September 2017 and these are due to be published shortly. The managing director has reviewed these financial statements and has prepared a list of queries arising out of the review.

Query One

I'm confused about our treatment of equity investments in listed entities that we don't control. There seem to be two different treatments in our financial statements. One of the notes to the financial statements says that the equity investments we hold to temporarily invest surplus cash balances are measured at fair value and that changes in fair value are recognised in profit or loss. Another note says that the equity investment we hold in a key supplier is measured at fair value and that changes in fair value are recognised in other comprehensive income (OCI). Earnings per share (EPS) is a key performance indicator for Omega, so please explain how it can be justified to use two different treatments for equity investments made by the same entity. Please also explain what the impact on EPS might be if a gain or loss is reported in OCI rather than profit or loss. (6 marks)

4 Query One

The accounting treatment of equity investments which we do not control or significantly influence is dealt with in IFRS 9 – *Financial Instruments*. ½

Under IFRS 9, equity investments are **financial assets** which fail the '**contractual cash flow test**'. Equity investments must be measured at **fair value**. ½ + ½

Under IFRS 9, gains or losses on the remeasurement of financial assets measured at fair value are normally taken to profit or loss. ½

In the case of equity investments **not held for trading**, it is possible to make an **irrevocable election at initial recognition** to recognise gains or losses on the remeasurement to fair value in **other comprehensive income**. ½+ ½+ ½

The IASB *Conceptual Framework for Financial Reporting* makes no clear conceptual distinction between gains and losses reported in profit or loss and gains and losses reported in other comprehensive income. ½

The distinction between profit or loss and other comprehensive income does have some practical relevance, however. ½

The distinction is particularly important for **listed** entities. Such entities are required to report their **earnings per share** under IAS 33 – *Earnings per Share*. **Gains and losses reported in profit or loss affect earnings per share** whereas gains or losses reported in other comprehensive income **do not**. ½ + ½ + ½

6

Query Two

I noticed that OCI includes a gain of $64 million relating to the revaluation of our portfolio of properties. I looked in the notes to check that a corresponding amount of $64 million had been added to property, plant and equipment. However, the note explaining movements in property, plant and equipment showed a revaluation increase of $80 million. There was a reference to tax in one of the notes I looked at but I don't see why this is relevant. I know our rate of tax is 20% and this would explain the difference but we won't pay any tax on this gain unless we sell the properties. We have no intention of selling any of them in the foreseeable future, so what relevance does tax have? Please explain the difference between the $64 million gain in OCI and the $80 million gain added to property, plant and equipment. (6 marks)

Query Two

The difference between the $64 million gain in the statement of comprehensive income and the $80 million gain included in property, plant and equipment is caused by deferred tax.	1
IAS 12 – *Income Taxes* – requires that deferred tax liabilities are recognised (with a very few exceptions) on all taxable temporary differences.	1
A taxable temporary difference arises when the carrying value of an asset increases but its 'tax base' does not.	1
When an asset is revalued, the carrying value increases but the tax base stays the same (as the future tax deductions are unaffected).	1
Therefore a revaluation of $80 million causes a taxable temporary difference of $80 million and (when the tax rate is 20%) an additional deferred tax liability of $16 million ($80 million x 20%).	1
This liability reduces the gain reported in the statement of comprehensive income to $64 million ($80 million – $16 million).	1
	6

Query Three

I'm aware that on 31 December 2016 we acquired a new subsidiary and therefore its results and net assets are included in our consolidated financial statements for the year ended 30 September 2017. I seem to recall from the discussions we held at the time that the year end of this subsidiary is 31 May rather than 30 September. How do we deal with the fact that the year ends are different when we prepare the consolidated financial statements? Do we have to prepare additional special information for this subsidiary when we consolidate? (4 marks)

Query Three

Under the provisions of IFRS 10 – *Consolidated Financial Statements* – the general rule is that the financial statements of all group members should have the same reporting date.	1
Where the reporting period of a subsidiary is different from the reporting period of the parent, that subsidiary should prepare, for consolidation purposes, additional financial information as of the same date as the financial statements of the parent.	1
Where it is 'impracticable' to prepare additional financial information, then the parent is permitted to consolidate the financial information of the subsidiary using the most recent financial information of the subsidiary 'adjusted for the effects of significant transactions or events in the intervening period'. 31 May 2017 to 30 September 2017 in this case.	1
For the above to be possible, the intervening period should be no longer than three months, so in this case additional interim financial information will have to be prepared.	1
	4

Query Four

As you know, my son owns a business that supplies us with a very small proportion of the components that we use in our production process. This business is one of a number that supply us with these components and the overall quantity is totally insignificant to us. I was very surprised to see that details of these transactions with my son's business have been disclosed in the notes to the draft financial statements. This seems ridiculous when transactions with far more significant suppliers are not disclosed at all. Please explain the rationale of this disclosure to me. (4 marks)

Query Four

Under the provisions of IAS 24 – *Related Party Disclosures* – your son's business is a related party to Omega.	1
Your son's business is a related party because the business is controlled by your son, who is one of your 'close family members' and you are a part of Omega's 'key management'.	1
IAS 24 requires disclosure of all transactions with related parties irrespective of their size.	1
IAS 24 states that transactions with related parties are material by their nature.	1
	4

June 2018

4 You are the financial controller of Omega, a listed entity which prepares consolidated financial statements in accordance with International Financial Reporting Standards (IFRS). The chief executive officer (CEO) of Omega has reviewed the draft consolidated financial statements of the Omega group and of a number of the key subsidiary companies for the year ended 31 March 2018. None of the subsidiaries are listed entities but all prepare their financial statements in accordance with IFRS. The CEO has sent you an email with the following queries:

Query One

I notice that the disclosures relating to operating segments in the consolidated financial statements appear to be based on the geographical location of the customers of the group. I am the non-executive director of another large listed entity and the segment disclosures in their consolidated financial statements are based on the type of products sold. Also some of our larger subsidiaries have customers located in more than one geographical region, yet they provide no segment disclosures whatsoever in their individual financial statements. I would like to see segment disclosures given in the individual subsidiary accounts as well. I really don't understand these inconsistencies given that all these financial statements have been prepared using IFRS. Please explain the reasons for these apparent inconsistencies.

(6 marks)

4 **Query One**

The relevant IFRS which deals with operating segments is IFRS 8 – *Operating Segments*. The definition of an operating segment in IFRS 8 is based around an entity's business model, which could be different from entity to entity and the disclosures focus on the information which management believes is important when running the business. 1 (principle)

IFRS 8 defines an operating segment as a component of an entity:

- Which engages in business activities from which it may earn revenues and incur expenses, and
- Whose operating results are regularly reviewed by the chief operating decision maker, and 2 (up to 2 for
- For which discrete financial information is available. detail of definition)

The 'chief operating decision maker' is a role rather than a title or it is a function and not necessarily a person. The role/function is defined around who monitors performance and allocates resources of the operating segments. 1

IFRS 8 is only compulsory for **listed** entities. If we wanted to include information regarding the operating segments of individual subsidiaries, then we **could** as IFRS 8 requires judgement in its application. However, the information in the individual financial statements would **either need to comply with IFRS 8 in all respects or the information cannot be described as 'segment information'**. ½ + ½ + 1

6

Query Two

When reading the accounting policies note in the consolidated financial statements I notice that we measure all of our freehold properties using a fair value model but that we measure our plant and equipment using a cost model. I further notice that both of these asset types are shown in the 'property, plant and equipment' figure which is a single component of non-current assets in the consolidated statement of financial position. It makes no sense to me that assets which are shown as property, plant and equipment are measured inconsistently. If it's OK to measure different parts of property, plant and equipment using two different measurement models, why not use the fair value model for the more readily accessible properties and use the cost model for the properties in remote locations to save on time and cost? (6 marks)

Query Two

IAS 16 – *Property, Plant and Equipment* (PPE) – allows (but does not require) entities to revalue its PPE to fair value. However, it requires that the measurement model used (cost or fair value) for PPE should be consistent on a class by class basis. 1 (principle)

A class of PPE is a **grouping of assets of a similar nature and use in an entity's operations**. Based on this definition, it is **likely that property (or 'land and buildings') would form one distinct class of PPE and that plant and equipment would form another class**. 1 + 1

Therefore it is perfectly consistent with IFRS for property to be measured under the revaluation (fair value) model and plant and equipment to be measured under the cost model. 1

However, it would be inappropriate to 'cherry pick' or apply a 'mixed measurement model' to property (or land and buildings) based simply on its geographical location. This prevents entities only revaluing items which have increased in value and leaving other items at their (depreciated) cost. 1

If we do use the fair value model, then we need to make sure we revalue with sufficient regularity to ensure that the carrying amount of the revalued asset is a true reflection of its current value. 1

6

Query Three

When I read the disclosure note relating to intangible non-current assets in the consolidated financial statements, I notice that this figure includes brand names associated with subsidiaries which we've acquired in recent years. However, the brand names which are associated directly with products sold by Omega (the parent entity) are not included within the non-current assets figure. This is another inconsistency that I don't understand. Please explain how this practice can be in line with IFRS requirements. One final question: would I be right in thinking that, as with property, plant and equipment, we can use the fair value model to measure intangible assets? (8 marks)

Query Three

Under the provisions of IAS 38 – *Intangible Assets* – the ability to recognise an intangible asset depends on how the potential asset arose. From the perspective of the Omega group, brand names generated by Omega are internally generated. The recognition criteria for such potential assets are very stringent and only costs associated with the development phase of an identifiable research and development project would satisfy them. This explains why the Omega brand names are not recognised.	1 (internally generated) + 2 (why cannot capitalise)
In contrast, intangible items which relate to an acquired subsidiary which exist at the date of acquisition are acquired as part of a business combination and for such assets the recognition criteria are different. Provided the fair value of such an intangible can be reliably measured at the date of acquisition, it is recognised in the consolidated statement of financial position based on its fair value at the date of acquisition.	1 (acquired with business combination) + 2 (mechanics of recognition)
The use of the fair value model for intangible non-current assets is restricted to those assets which are traded in an active market. This is relatively uncommon in the case of intangibles. It is most unlikely that brand names would be traded in such a market, so the fair value model is unlikely to be available here.	1 (principle) + 1 (conclusion)
	8

Dec 2018

4 You are the financial controller of Omega, a listed entity which prepares consolidated financial statements in accordance with International Financial Reporting Standards (IFRS® Standards). The financial statements for the year ended 30 September 2018 are due to be published shortly. A trainee accountant who is assigned to your department is reviewing the financial statements as part of a training exercise. She has prepared a list of queries arising out of this review.

Query One

When I look at the statement of financial position, one of the categories of non-current assets is 'investment properties' and another category is 'property, plant and equipment' – in which all other properties are included. Surely we invest in all our properties, so why have two categories for them in the statement of financial position? How do we decide what goes where?

A note to the financial statements states that investment properties are measured at their fair values and not depreciated. Don't all non-current assets have to be depreciated over their estimated useful lives? Another note states that property included in property, plant and equipment is measured at cost less accumulated depreciation rather than at fair value. Shouldn't all properties be measured in the financial statements on a consistent basis?

Finally, I can't immediately see from the financial statements where the gains or losses relating to the measurement of investment properties are included. The profit statement seems to include two main components – profit or loss and other comprehensive income. Where would the gains or losses go? Presumably the treatment of gains and losses is the same for any non-current assets which are measured at fair value? (10 marks)

4	**Query One**	
	Properties which are held for investment purposes are dealt with in IAS® 40 – *Investment Properties*.	½
	IAS 40 defines investment properties as property held for rental or capital appreciation or both rather than for use in the ordinary course of business (give credit if wording different but correct in principle).	1
	Under IAS 40, there are two permitted methods of accounting for investment properties.	½ (principle)
	One of these methods is the **fair value method**. Under this method investment properties are **not depreciated**, but are measured **annually at fair value**, with **gains or losses on re-measurement being recognised in the statement of profit or loss**.	½ + ½ + ½ + ½
	We could have chosen to measure our investment properties under the cost model (the model we have used to measure our other properties (see below)).	½
	Where a property **is used in the ordinary course of business it is included in property, plant and equipment** and **subject to a different IFRS® Standards – IAS 16 – *Property, Plant and Equipment***.	½ (principle) + ½ (principle)

IAS 16 allows properties to be measured under two alternative models.	½ (principle)
Under one of these models – **the cost model** – properties are measured at **original cost less accumulated depreciation**. This is the model we have **chosen to use in our financial statements**.	½ + ½ + ½
Under the revaluation model of IAS 16, **gains on revaluation are generally recognised in other comprehensive income** but **losses (falling below carrying amount) are generally recognised in the statement of profit or loss**. The only **exception to recognising a surplus in other comprehensive income** is when it **reverses a previous deficit which was recognised in the statement of profit or loss**. In such cases, the reversal is recognised in the statement of profit or loss also.	½ + ½ + ½ + ½ + ½
	10

Query Two

When I looked at the note detailing the intangible assets we include in our consolidated statement of financial position, I noticed that several brand names associated with subsidiaries we acquired recently were included in this figure. Therefore I also expected to see a figure for the Omega brand name included within intangible assets. There doesn't appear to be any amount for the Omega brand name included within intangible assets and I don't understand why. The Omega brand name has been developed within Omega for a number of years and is well regarded by our customers. Surely it's a mistake not to include it as well? (6 marks)

Query two

The accounting treatment of intangible assets is regulated by IAS 38 – *Intangible Assets*.	½ (principle)
Under IAS 38, the accounting treatment of intangible assets depends on how they arose.	½ (principle)
The intangible assets of acquired subsidiaries were acquired as a result of a business combination and the initial recognition requirements are contained in IFRS® 3 – *Business Combinations*.	½ (principle)
When a new subsidiary is acquired, the purchase consideration needs to be allocated to the identifiable assets and liabilities of the acquired subsidiary.	½ (principle)
A brand name (or any other intangible asset for that matter) is regarded as identifiable if it is **separable** (can be sold without selling the whole business) or arises from **contractual or other legal rights** (such as legally protecting its use).	½ + ½
Identifiable intangible assets associated with an acquired subsidiary **can be recognised separately in the consolidated financial statements provided their fair value can be reliably estimated**.	1
The Omega brand is an internally developed brand.	½ (principle)
IAS 38 does **not allow** the recognition of internally developed brands because of the **inherent difficulties** involved in identifying and measuring them.	½ + ½
This explains why the Omega brand is treated differently compared to the brands of acquired subsidiaries.	½
	6

Query Three

One of the notes to the financial statements refers to a legal claim made against Omega by Customer X. This relates to losses incurred by Customer X due to Omega supplying this customer with a faulty product. Further investigation revealed that the fault was due to one of Omega's suppliers, Supplier Y, supplying Omega with a faulty component. This component was used to manufacture the product supplied to Customer X. Therefore Omega made a legal claim against Supplier Y in respect of that faulty component. The note states that both legal claims will probably succeed. I don't understand why Omega's financial statements include a liability in respect of the expected settlement of Customer X's legal claim but do not include an asset in respect of the expected settlement of Omega's legal claim against Supplier Y. This seems inconsistent. (4 marks)

Query three

The accounting treatment of both items is governed by IAS 37 – *Provisions, Contingent Liabilities and Contingent Assets*.	½ (principle)
The legal claim **against** Omega is a provision as it is a liability of uncertain timing or amount.	½ (principle)
IAS 37 requires provisions to be recognised where there is a **probable outflow** of economic benefits which can be reliably measured.	½
The legal claim **by** Omega against Supplier Y is a contingent asset as it is a possible asset arising from past events.	½ (principle)
IAS 37 states that contingent assets should **not** be recognised in the financial statements but should be **disclosed** where there is a **probable** inflow of economic benefits.	½ + ½ + ½
This explains the distinction between the treatment of the two legal claims.	½
	4

June 2019

Q3:

(a) It has become increasingly common for entities to use share-based payment methods and the most common example is to grant employees share options as part of a remuneration package. These options often vest at the end of a specified period, and are subject to vesting conditions. IFRS 2 – *Share-based Payment* – has been issued to provide financial reporting guidance for entities which engage in this type of transaction.

Required:

(i) **Explain how share options granted to employees with a future vesting date and subject to vesting conditions should be recognised and measured in the financial statements of the employing entity. Your explanation need only include the treatment of non-market based vesting conditions.** (6 marks)

(ii) **Explain what would be the changes to your answer if instead the entity granted share appreciation rights which are payable in cash to the employees at the end of the vesting period.** (3 marks)

(i) IFRS 2 – *Share-based Payment* – requires that the total estimated cost of granting share options to employees be recognised over the vesting period. ½

The total estimated cost should be charged as a remuneration expense and credited to equity (IFRS 2 does not specify where in equity the credit should be made). 1

The cumulative charge at the end of each period should be a proportion of the total estimated cost. The proportion should be based on the proportion of the total vesting period which has accrued at the reporting date. 1

The incremental charge is a remuneration expense for any period and should be the difference between the cumulative charge at the end of the period and the cumulative charge at the start of the period. 1

The charge should be based on the fair value of the option at the grant date. This continues to be the case throughout the vesting period – subsequent changes in the fair value of the option are not adjusted for. 1½

Where the vesting conditions are non-market conditions (i.e. not directly related to any change in the entity's share price), then the cumulative cost at each year end should be estimated based on the expected number of options which will vest at the vesting date. 1

6

(ii) If an entity grants cash-based share appreciation rights to employees rather than share options, then the basic principle of recognising the total estimated cost over the vesting period taking account of relevant vesting conditions is the same. 1

However, since any ultimate payment will be made in cash, the credit entry to account for the remuneration expense is to liabilities rather than equity. 1

Also, since any ultimate payment to the holders of share appreciation rights will normally be based on their fair value either at the vesting date or the payment date, subsequent changes in the fair value of the rights cannot be ignored. Measurement of the remuneration expense will be based on the fair value of the share appreciation rights at each reporting date. 1

3

4 You are the financial controller of Epsilon, a listed entity. The financial statements of Epsilon for the year ended 31 March 20X7 are currently being prepared. Your managing director has sent you three questions regarding the financial statements. The questions appear in notes 1–3.

Note 1 – Farming subsidiary

I've recently been reviewing the financial statements of one of our subsidiaries. This subsidiary specialises in both dairy farming and beef farming. There are amounts included in both non-current and current assets:

– The non-current assets include farm machinery which has been purchased. I understand why this machinery has been included as we have spent money on it. However, the non-current assets figure also includes a figure for the dairy and beef herds. These existing herds were not purchased but are made up of animals the farming subsidiary has bred.

– The inventories include amounts for milk and beef. The milk comes from the dairy herd and the beef comes from the animals we have slaughtered.

– Is there an international financial reporting standard which deals with these issues and how does it require the subsidiary to value and account for the herds and the inventories? (8 marks)

Note 1 –Farming subsidiary

There is an international financial reporting standard which is particularly applicable to entities such as farming companies. The standard is IAS 41 – *Agriculture*.	1 (principle)
IAS 41 would regard a dairy or beef herd as an example of a **biological asset**. A biological asset is a **living plant or animal**.	½ + 1
Given the impracticability of measuring the cost of biological assets, IAS 41 requires that they should be measured at each reporting date at their **fair value less costs to sell**, provided that fair value can be measured **reliably**. Gains and losses are reported in profit or loss.	1 + ½
Dairy and beef cows are regularly bought and sold and therefore there should be no problem in determining their fair value which will be equivalent to market value. This would allow the calculation of the carrying amount of the dairy and beef herd in the non-current assets of the subsidiary.	1
IAS 41 would regard milk and beef as agricultural produce. Agricultural produce is 'harvested' from the biological asset. In the case of the dairy herd, the 'harvesting' is the milking of the cows and in the case of the beef herd, the 'harvesting' is the slaughtering of the beef cows.	2
IAS 41 requires that agricultural produce be initially measured based on fair value at the point of harvesting. This then forms the 'cost' for the purposes of subsequently applying IAS 2 – *Inventories*.	1
	8

Note 2 – Equity investments

I've been analysing Epsilon's equity investments and they appear to be being treated inconsistently in the financial statements. I have noted the following:

- We have a portfolio of equity investments which we use for the short-term investment of surplus cash. When we need cash for business purposes we sell some investments from this portfolio. The portfolio is measured at its fair value each year end. Any surpluses or deficits on re-measurement to fair value are recognised in investment income as part of the profit or loss for the period.
- We have two long-term equity investments in key suppliers which we have held for some time and have no intention of selling. These investments are also measured at fair value but changes in fair value are recognised as 'other comprehensive income'.

How can it be consistent to report changes in the fair values of our equity investments as different line items in the same financial statement? Please explain the measurement requirements of the relevant international financial reporting standard. Additionally, what difference does it make to Epsilon whether gains or losses are reported in other comprehensive income rather than as part of the profit or loss for the period? (7 marks)

Note 2 – Equity investments

Equity investments are financial assets and are subject to the recognition and measurement requirements of IFRS 9 – *Financial Instruments*.	½
IFRS 9 identifies three classes for financial assets – amortised cost (AC), fair value through other comprehensive income (FVTOCI) or fair value through profit or loss (FVTPL).	1
IFRS 9 states that the class of into which a particular financial asset is allocated depends on the business model for managing the financial assets and the contractual cash flows associated with those assets. AC can only be used where the contractual cash flows consist solely of the receipt of interest and repayment of the principal sums outstanding. This does not apply to equity shares, so the AC method cannot be used.	1½
The default category for measuring equity investments is at FVTPL. This is the method which has been used for the portfolio which has been held for the short-term investment of surplus cash.	1
However, if an equity investment is not held for trading, it is possible to make an election on initial recognition to measure the investment at FVTOCI. This election has been made in respect of the equity investments in two key suppliers which we have held for the long term and have no intention of selling.	1½
The key difference between reporting a gain or loss as part of profit or loss or as part of other comprehensive income is that in the former case the gain or loss affects earnings per share, which is an important performance measure for listed entities like Epsilon.	1½
	7

Note 3 – Redundancy programmes

You will be aware that the board of directors met on 10 March 20X7 to discuss over-capacity in parts of the group. The decision was reluctantly taken to implement a programme of redundancies. The programme was to be implemented in two phases:

- Phase 1 involves 300 redundancies on 30 June 20X7. This phase of the programme was planned out in detail at the meeting on 10 March 20X7. The redundancy costs were calculated in some detail at the meeting and this first phase was made public to all affected parties on 25 March 20X7.
- Phase 2 involves 200 redundancies on 30 September 20X7. This phase of the programme was also planned out in detail at the meeting on 10 March. The redundancy costs were estimated at the meeting and this second phase was announced on 25 April 20X7.

The financial statements for the year ended 31 March 20X7 include a provision for the first phase of the redundancies but not the second phase. Both phases were agreed and the costs calculated at the same meeting. Surely both costs should be accounted for consistently? (5 marks)

Note 3 – Treatment of redundancy programmes

Provisions are subject to the requirements of IAS 37 – *Provisions, Contingent Assets and Contingent Liabilities*.	½
IAS 37 states that in order for a provision to be recognised, an obligation needs to exist at the reporting date which can be measured reliably.	1
The costs of both phases of the redundancy programme have been either estimated or calculated, so for both phases the potential obligation can be measured reliably.	½
The reason for the different treatments of the two phases is due to whether or not an obligation exists at the reporting date.	½ (principle)
An obligation can be legal or constructive; in this case the redundancy programme was determined internally by the company so the obligation is not a legal one.	½ (principle)
In the case of phase 1 of the programme, a constructive obligation does exist at the reporting date because the details have been announced to those affected by it, giving them a valid expectation that it will be carried through. Therefore IAS 37 requires a provision for the costs to be included in the financial statements. As no such obligation exists for phase 2 at the reporting date, since the announcement had not been made at that time, neither a provision or disclosure of a contingent liability is required.	2
	5

Dec 2019

Q3

(a) IFRS® 15 – *Revenue from Contracts with Customers* – was issued in September 2015 and applies to accounting periods beginning on or after 1 January 2018. IFRS 15 replaces IAS 11 – *Construction Contracts* – and IAS 18 – *Revenue*. IFRS 15 contains principles which underpin the timing of the recognition of revenue from contracts with customers and the measurement of that revenue.

Required:

Explain the principles underpinning the TIMING of revenue recognition and the MEASUREMENT of that revenue which are outlined in IFRS 15. You should provide examples of revenue transactions to support your explanations of these key principles. (12 marks)

(a) The timing of the recognition of revenue under IFRS 15 – *Revenue from Contracts with Customers* – depends on the type of performance obligation the entity has under the contract with the customer. A performance obligation is a distinct promise to transfer goods or services to the customer (sense of the point only required). 1 (principle)

IFRS 15 requires that revenue should be recognised when (or as) a particular performance obligation is satisfied. 1 (principle)

In many cases (e.g. the sale of goods in the ordinary course of business), performance obligations are satisfied at a point in time. In such cases, the revenue is recognised at the point control of the goods is transferred to the customer. 2

In some cases (e.g. a contract to construct an asset for use by a customer), performance obligations are satisfied over a period of time. In such cases, the proportion of the total revenue recognised is the proportion of the performance obligation which has been satisfied by the reporting date. 2

The measurement of revenue is based on the transaction price. The transaction price is the amount of consideration to which an entity expects to be entitled in exchange for transferring the promised goods and services to the customer. 1

In many cases, where the consideration for the transaction is fixed and payable immediately after the revenue has been recognised (e.g. most sales of goods), the transaction price is the invoiced amount less any sales taxes collected on behalf of third parties. 1

Where the due date for payment of the invoiced price is 'significantly different' (certainly more than 12 months) from the date of recognition of the revenue, then the time value of money should be taken into account when measuring the transaction price. This means that the revenue recognised on the sale of goods with deferred payment terms would be split into a 'sale of goods' component and a financing component. 2

Where the total consideration due from the customer contains variable elements (e.g. the possibility that the customer obtains a discount for bulk purchases depending on the total purchases in a period), then the transaction price should be based on the best estimate of the total amount receivable from the customer as a result of the contract. 2

12

4 Epsilon, a company with a year end of 30 September 20X7, is listed on a securities exchange. A director of Epsilon has a number of questions relating to the application of International Financial Reporting Standards (IFRS® Standards) in its financial statements for the year ended 30 September 20X7. The questions appear in notes 1–3.

Note 1 – Inconsistencies

I have recently been appointed to the board of another company which is growing very quickly and will probably seek a securities exchange listing in the next few years. As part of my familiarisation process, I've been reviewing their financial statements which they state comply with IFRS Standards. I have been comparing them with the financial statements of Epsilon. There appear to be some inconsistencies between the two sets of financial statements:

- The financial statements of the other company contain no disclosure of the earnings per share figure and there is no segmental analysis despite this company having a number of divisions with different types of business. Epsilon gives both of these disclosures.
- Both Epsilon and this other company have received government grants to assist in the purchase of a non-current asset. We have deducted the grant from the cost of the non-current asset. They have recognised the grant received as deferred income.

Please explain the apparent inconsistencies to me. (7 marks)

4 Note 1 – Inconsistencies

It is possible for two sets of financial statement to comply with IFRS standards and yet be inconsistent with each other. Some individual IFRS standards allow a choice of accounting treatment and some IFRS standards are only compulsory for listed entities like Epsilon. 2

Both IFRS 8 – *Operating Segments* – and IAS® 33 – *Earnings per Share* – are only compulsory for listed entities. The other company is not currently listed and is not required to give either of these disclosures but can do so on a voluntary basis. If the other company obtains a listing, then they will have to give these disclosures. 2

IAS 20 – *Accounting for Government Grants and Disclosure of Government Assistance* – requires government grants to be recognised in profit or loss on a systematic basis over the period in which the entity recognises as expenses the related cost. However, IAS 20 allows entities to choose from two alternative models for presenting the government grants. These are the approach, which Epsilon uses, which deducts the grant in arriving at the non-current asset's carrying amount and will result in a reduced depreciation charge through profit or loss. The other company uses the allowed alternative of setting up the grant as deferred income and releasing the grant systematically to profit or loss. The net effect on profit or loss will be the same, whichever approach is used. Consistency of choice is required **within** entities. Therefore the other company could continue to use the deferred income approach to present its government grants even after obtaining a listing. 3

7

Note 2 – Pending legal cases

At a recent board meeting, we discussed legal cases which customers A and B are bringing against Epsilon in respect of the supply of products which were allegedly faulty. We supplied the goods in the last three months of the financial year.

We have reliably estimated that if the actions succeed, we are likely to have to pay out $10 million in damages to customer A and $8 million in damages to customer B.

Epsilon's legal advisers have reliably estimated that there is a 60% chance that customer A's claim will be successful and a 25% chance that customer B's claim will be successful.

I know we have insurance in place to cover us against claims like this. It is highly probable that any claims which were successful would be covered under our policy. Therefore I would have expected to see a provision for legal claims based on the likelihood of the claims succeeding. However, I would also have expected to see an equivalent asset in respect of amounts recoverable from the insurance company. The financial statements do contain a provision for $10 million but no equivalent asset. Disclosure of the information relating to both of the claims and the associated insurance is made in the notes to the financial statements. How can it be the correct accounting treatment to include a liability but not the corresponding asset, given the above facts? (12 marks)

Note 2 – Pending legal cases

Provisions are covered by IAS 37 – *Provisions, Contingent Liabilities and Contingent Assets*. IAS 37 states that for a provision to be recognised, an obligating event must have incurred before the year end. In this case, both customer A and B were sold the product before the year end so an obligating event has occurred. 2

Marks

IAS 37 further states that a provision is only recognised when there is a probable outflow of economic benefits. IAS 37 interprets 'probable' to be 50% or more. This is only the case with the supply to customer A, so it is correct to only recognise a provision for customer A's claim. 3

IAS 37 also states that any provision should be measured based on the best estimate of the likely outflow of economic benefits. In this case, this amount is $10 million. 2

Any liability arising from the legal case brought by customer B would be regarded as a contingent liability because there is only a possible (rather than a probable) chance of an outflow of economic benefits. In this case, it is dealt with by disclosure, rather than provision. 2

In addition to the recognition of a provision in the case of customer A's claim, it is also necessary to disclose key facts relating to the case in the notes to the financial statements. 1

The possible recovery of funds from the insurance company would be regarded as a contingent asset. This would always be the case for possible assets unless it is virtually certain (rather than highly probable) that there will be an inflow of economic benefits. Where there is a probability of an inflow of funds relating to a contingent asset, then this is dealt with by disclosure under IAS 37. 2

12

Note 3 – Statement of profit or loss and other comprehensive income

I've been reviewing the statement of profit or loss and other comprehensive income and it appears to be in two sections. The first section appears to be entitled 'profit or loss' and the second 'other comprehensive income'. It appears that the tax charge is included in the 'profit or loss' section of the statement as there is no tax charge included in the 'other comprehensive income' section of the statement. I have a number of questions regarding this statement:

- How do we decide where to put a particular item of income or expenditure?
- Where does the tax relating to 'other comprehensive income' get shown?
- Do the above points have an impact on the computation of performance evaluation indicators which will be of interest to shareholders? (6 marks)

Note 3 – Statement of profit or loss and other comprehensive income

The principles underpinning the overall presentation of financial statements are set out in IAS 1 – *Presentation of Financial Statements*. IAS 1 requires that **all** income and expenses are presented in a statement of profit or loss and other comprehensive income.	1
IAS 1 does not allow entities to choose whether to present income and expenses in the profit or loss or the other comprehensive income section of the statement. IAS 1 states that, unless required or permitted by a specific IFRS standard, all items of income and expense should be presented in the profit or loss section of the statement.	2
IAS 1 states that the tax relating to items of other comprehensive income is either shown as a separate line in the 'other comprehensive income' section of the statement or netted off against each component of other comprehensive income and disclosed in the notes to the financial statements.	2
The key implication of an item being presented in other comprehensive income rather than profit or loss is that the item would not be taken into account when measuring earnings per share, an important performance indicator for listed entities like Epsilon.	1
	6

June 2020

4 Omega is a listed entity and you are the financial controller. The financial statements of Omega for the year ended 31 March 20X5 are currently being prepared. One of Omega's directors has sent you three questions regarding the financial statements.

Question 1 – Right-of-use asset

When I looked at the note which gave details of our property, plant and equipment, a separate component appeared for the first time this year. This component was described as a right-of-use asset. Upon further investigation, I discovered that this related to a warehouse which we started to lease on 1 October 20X4 to provide us with more capacity. The warehouse is being leased on a five-year lease contract at an annual rental of $500,000, payable in arrears. There is no option to extend the lease at the end of the five-year period. Based on current annual interest rates (10%), these rentals have a total present value of $1,895,000.

We incurred direct costs of $105,000 when arranging this lease with the owner. The carrying amount of the right-of-use asset which is shown in the financial statements is $1·8 million. I don't understand this at all. In particular, I have three questions about this that I would like you to answer:

– The warehouse would cost at least $10 million to purchase outright and has a useful life of around 25 years. How can it be presented as Omega's asset in these circumstances?

– Where does the figure of $1·8 million come from?

– Apart from the right-of-use asset, how else will this transaction affect our financial statements? I don't need detailed workings here, just explanations. (11 marks)

4 Question 1 – Right-of-use asset

IFRS 16 – *Leases* – requires a lessee to recognise a right-of-use asset in all circumstances other than for very short leases (of one year or less) or for low value assets. A warehouse lease for five years is neither of these, so recognition of a non-current asset will be required in our financial statements.	2
The initial carrying amount of the right-of-use asset comprises the present value of the lease payments plus any direct costs we incurred in arranging the lease.	1 (principle)
In this case, therefore, the initial carrying amount at 1 October 20X4 will be $2 million ($1,895,000 + $105,000).	1
The right-of-use asset is included as a separate component of property, plant and equipment and depreciated over the lease term.	1 (principle)
The depreciation of the asset for the year ended 31 March 20X5 will be $200,000 ($2 million x 1/5 x 6/12).	1
Therefore the carrying amount of the right-of-use asset at 31 March 20X5 will be $1,800,000 ($2 million – $200,000).	1
When the right-of-use asset is recognised, a lease liability is also recognised. It is initially measured at the present value of the lease payments – $1,895,000 in this case.	1 (principle)
The liability will be increased by a finance cost. This cost is based on the carrying amount of the liability and the rate of interest implicit in the lease.	1 (principle)
The finance cost will be charged as an expense in the statement of profit or loss.	½ (principle)
When the lease rentals are paid, they will be treated as a repayment of the lease liability.	½ (principle)
Since a lease rental is due for payment six months after the year end, $500,000 of the lease liability will be treated as a current liability. The balance will be non-current.	1 (principle)
	11

Question 2 – Segment reporting

I know that, because we're a listed entity, we are required to disclose details of the financial performance and financial position of different business segments in the notes to our financial statements. I thought it would be interesting to compare the segment report in our financial statements with that of a key competitor. When I did this, I found myself very confused. Our segment report was based on the performance and position by geographical area whereas our competitor's report was based on the performance and position by product type.

How can this be correct when both of us are preparing our financial statements in accordance with International Financial Reporting Standards (IFRS® Standards) – is there not a definition of a 'segment' that would be applied to all businesses?

(8 marks)

Question 2 – Segment reporting

IFRS 8 – *Operating Segments* – requires entities to which it applies to provide a segment report based on its operating segments.	1 (principle)
An operating segment is a **business component** for which **discrete financial information is available** and whose operating results are regularly reviewed by the **chief operating decision maker** (exact words not needed).	3
The chief operating decision maker is the person (or persons) who assesses performance and allocates resources (exact words not needed).	1
Omega assesses performance and allocates resources on a geographical basis whereas our competitor more than likely does this on a 'product type' basis (mark for coming to a logical conclusion).	1
Notwithstanding the above, IFRS 8 normally requires **all** entities to give details of revenues by geographical area and by product type and non-current assets by geographical area.	1 (principle)
However, the above is not required if the information could only be made available at a prohibitive cost. This may explain the discrepancy between the segment reports.	1
	8

Question 3 – Immaterial transactions

You may know that the contract for cleaning our Head Office has been given to a firm which is controlled by my brother. This contract was approved in the normal way and I was not involved in the approval process to avoid any perception of a conflict of interest as my brother and I are known to holiday and socialise together. The contract has normal commercial terms and is very insignificant in the context of Omega as an entity. I'm very surprised, therefore, to see details of this contract disclosed in our financial statements when many other much more financially significant contracts are not disclosed in the same detail. Surely this disclosure is unnecessary when the monetary amounts are so small and there is nothing 'out of the ordinary' about the contract? (6 marks)

Question 3 – Immaterial transactions

Under the principles of IAS 24 – *Related Party Disclosures* – your brother's firm is a related party of Omega.	1 (principle)
This is because the firm is controlled by the close family member (your brother) of a member of the key management personnel of Omega (yourself).	2
IAS 24 requires that the existence of all related party relationships be disclosed together with details of any transactions and outstanding balances (exact words not needed).	2
IAS 24 regards related party relationships as material by their nature so the fact that the transaction is financially insignificant and ordinary to Omega is not relevant in terms of requiring the disclosure.	1 (principle)
	6

Dec 2020

Question 4

You are the financial controller of Omega, a listed entity involved in the exploration for and evaluation of mineral resources. One of Omega's directors has raised some queries following his review of the consolidated financial statements for the year ended 30 September 20X5.

The following **exhibits**, available on the left-hand side of the screen, provide information relevant to the question:

1. Exploration and evaluation assets.
2. Events after 30 September 20X5.
3. Use of IFRS Standards.

This information should be used to answer the question **requirement** within the **response option** provided.

Point 1: Exploration and evaluation assets

When I looked at our financial statements, I saw a note which gave a breakdown of our exploration and evaluation assets. I compared it with that of a competitor and I have the following three questions.

First, both notes showed the breakdown of the exploration and evaluation assets figure into various categories but they are not presenting the same categories despite both companies operating in similar ways. How can this be right when both companies use IFRS Standards to prepare their financial statements?

Second, why does neither company include the costs of developing mineral resources as part of the exploration and evaluation assets figure? As a key part of both of our businesses, should these costs not be recognised as part of this figure?

Finally, the financial statements state that we measure our exploration and evaluation assets using the cost model while the competitor's state they use the revaluation model. Is this an acceptable inconsistency when both companies are preparing financial statements in accordance with IFRS Standards?

(7 marks)

4 Exhibit 1 – Exploration and evaluation assets

IFRS 6 – *Exploration for and Evaluation of Mineral Resources* – specifies financial reporting in this area. ½ (principle)

IFRS 6 does not specifically prescribe what expenditures should be included as exploration and evaluation assets. Relevant entities are allowed to determine an accounting policy which specifies which expenditures should be included as exploration and evaluation assets and must apply it consistently. (Exact wording not needed – just the overall sense of the point.) 2

IFRS 6 states that, in making this determination, entities should consider the degree to which the expenditure can be associated with finding the specific mineral resources it is seeking. 1

Therefore it is quite possible that two entities in fairly similar sectors might make a different assessment of their accounting policies given very specific criteria which might apply to one entity or another. (Exact wording not needed – just the overall sense of the point.) 1

IFRS 6 does, however, **specifically prohibit** the inclusion of the costs of developing mineral resource in the exploration and evaluation assets figure. Such expenditures should be accounted for in accordance with **IAS 38** – *Intangible Assets*. 1 + ½

IFRS 6 allows exploration and evaluation assets to be measured under either the cost model or the revaluation model. 1

7

Point 2: Events after 30 September 20X5

When I read two notes to our financial statements, they seemed to contradict each other. One of the notes referred to a legal case from December 20X4 in which we were being sued for damages by a customer. We originally thought Omega would have to pay damages of $5 million but the case was finally settled for $5·5 million on 20 October 20X5. The financial statements at 30 September 20X5 presented a liability for $5·5 million, despite this only being confirmed after the year end.

A second note referred to the major fire in one of our factories on 15 October 20X5. The damage caused to the factory is estimated at $5·75 million. However, the note says that no adjustments have been made to the amounts recognised in the financial statements for the year ended 30 September 20X5 in respect of the damage caused by the fire. This will have a significant, but temporary impact on the cash flow of the business, however, it will **not** cause our own going concern status to be in doubt.

The two events are not being treated consistently despite the financial amounts being similar. Please can you explain these apparent inconsistencies?

I am aware that a major customer, owing us a significant amount, became insolvent on 20 November 20X5. We are unlikely to recover much, if any, of this debt. Why don't the financial statements contain at least a note explaining to our shareholders what has happened?

I am aware that the financial statements were authorised for issue on 15 November 20X5.

(10 marks)

Exhibit 2 – Events occurring after 30 September 20X5

The accounting treatment of events occurring after the year-end date is set out in IAS 10 – *Events after the Reporting Period*.	½ (principle)
IAS 10 defines events after the reporting period as being those events occurring after the end of the reporting period up to the date the financial statements are authorised for issue (15 November 20X5).	1
IAS 10 classifies events after the reporting period into two types – adjusting and non-adjusting.	½ (principle)
Adjusting events provide additional evidence of conditions existing at the reporting date. (Exact wording not needed – just the overall sense of the point.)	1
The information about the legal case provides additional evidence about the final liability and so is an adjusting event, so it is proper to recognise the correct amounts ($5·5m) in the financial statements. (Exact wording not needed – just the overall sense of the point.)	2
The fire at the factory does not relate to conditions at the reporting date and so is non-adjusting.	1
IAS 10 requires **disclosure** of the impact of non-adjusting events in the notes to the financial statements. The only exception to this rule would be if the event impacted on the **going concern** status of Omega. This is not the case based on the information provided.	1 + 1
The insolvency of the customer occurred after the financial statements were authorised for issue so it is not reportable in the financial statements for the year ended 30 September 20X5. (Exact wording not needed – just the overall sense of the point.)	2
	10

Point 3: Use of IFRS standards

You will know that we acquired a new subsidiary, Epsilon, on 1 October 20X4. Epsilon has a year end of 30 September and has prepared financial statements using national accounting standards, not IFRS Standards. Now that they have become part of the Omega group, we will of course require them to use IFRS Standards. We have incorporated their results into our consolidated financial statements using IFRS Standards but Epsilon needs to know what to do in its own financial statements. They have the IFRS Standard compliant financial statements for the year ended 30 September 20X5 but what about the comparative figures? Can they use the financial statements for their year ended 30 September 20X4, prepared under the national accounting standards, as comparative figures for their 20X5 financial statements? Please let me know how to advise the financial controller of Epsilon.

(8 marks)

Exhibit 3 – Use of IFRS Standards in the financial statements of a subsidiary

The principles underpinning the first-time preparation of financial statements under IFRS Standards are set out in IFRS 1 – *First-time Adoption of International Financial Reporting Standards*. ½

IFRS 1 requires that **both the financial statements for the current period and the comparative figures be presented using IFRS Standards in force at the first reporting date** under IFRS Standards. **In this case, this date is 30 September 20X5**. 1

The starting point for the first-time adoption of IFRS Standards is to prepare the opening IFRS Standards statement of financial position. This is the statement of financial position at **the start of the earliest period** for which Epsilon presents comparative information in its first full IFRS Standards financial statements. In Epsilon's case, this date is **1 October 20X3**. 1 + ½

Unless there is objective evidence that they were in error, the accounting estimates used in the opening IFRS Standards statement of financial position should be consistent with those used in the financial statements of Epsilon's prepared using national standards. 1

The **opening** IFRS Standards statement of financial position needs to be published in Epsilon's first set of IFRS Standards financial statements. Therefore the financial statements at 30 September 20X5 will contain three statements of financial position, rather than the usual two. 1

Despite there being three statements of financial position in the financial statements for the year ended 30 September 20X5, there will be only two statements of profit or loss and other comprehensive income and statements of changes in equity in these financial statements. 1

There is likely to be a difference between the net assets at 1 October 20X3 using national standards and the net assets using IFRS Standards. This difference will be recognised in the statement of changes in equity for the comparative period, rather than in the statement of profit or loss and other comprehensive income. 1

The first set of IFRS Standards financial statements need to include reconciliations of equity at all dates previously reported under national standards to equity reported under IFRS Standards. In the case of Epsilon, reconciliations will be required at 1 October 20X3 and 30 September 20X4. 1

8

June 2021

Requirements:

Delta prepares financial statements to 31 March each year. Delta has a number of subsidiaries which operate in a number of different business sectors.

The following **exhibits**, available on the left-hand side of the screen, provide information relevant to the question:

1. Cattle and sheep – details of the cattle and sheep herds owned by subsidiary Omega which operates in the agricultural sector.
2. Purchase of shares – details of the purchase of shares in a trading portfolio by subsidiary Kappa.
3. Acquisition of subsidiary – information on the acquisition of subsidiary Zeta including the fair value of its factory.

This information should be used to answer the question **requirements** within your chosen **response option(s)**.

Question 4

Note 1

I know during the year ended 31 March 20X5 we acquired Newby. Newby is a small company which operates in the construction industry. I also know that the shares in Newby were previously owned equally by three family members, and that Newby's borrowing was a bank loan. I had a look at Newby's audited individual financial statements for the current year. The audit report identified no issues with how the financial statements had been prepared but I don't understand how this can be correct. Newby is located in the same country as we are and is subject to the same regulatory regime. The financial statements of Newby do not appear to be wholly compliant with full International Financial Reporting Standards (IFRS standards). For example, the notes to Newby's financial statements state that all borrowing costs are expensed as they are incurred despite some of these borrowings relating to the construction of a new factory. Furthermore, the notes to Newby's financial statements don't appear to contain all the disclosures required by full IFRS standards.

Please can you answer the following questions (I don't need to know the mechanics of the consolidation process – I know that already):

1. Please explain why Newby has been allowed to prepare individual financial statements which don't appear to wholly comply with full IFRS standards.
2. Please explain if Newby will need to use full IFRS standards in its own financial statements now that it's part of our group.

(8 marks)

4 Newby

Because Newby was previously owned by three private shareholders and does not operate in the banking or finance sector, it is regarded as an entity which is not **publicly accountable**.	1 + 1
In these circumstances, Newby is **permitted, but not required**, to adopt the simplified form of financial reporting set out in the IFRS for Small and Medium Sized Entities (**the IFRS for SMEs**).	1 + 1
The IFRS for SMEs restricts the recognition of assets and liabilities in certain circumstances (e.g. borrowing costs are always expensed under the IFRS for SMEs). In addition, the disclosure requirements of the IFRS for SMEs are less than for full IFRS standards.	1 + 1
Even though Newby is now part of a group which will use full IFRS in its consolidated financial statements, Newby would **still be able** to use the IFRS for SMEs in its own individual financial statements. **Adjustments** would of course be required at consolidation level to make the consolidated financial statements fully IFRS standard compliant.	1 + 1
	8

Note 2

You will know that during the year we made a strategic long-term investment in Sandy, an entity which is a vital part of our supply chain. I believe we purchased 40% of the shares, which carry one vote each, and that this gave us the right to appoint four of the ten directors. The other six directors are independent of each other – they don't always agree when voting. I was expecting to see Sandy included as a subsidiary in our consolidated financial statements but instead the investment has been shown as a single figure in our consolidated statement of financial position. The carrying amount of the investment is presented as $40 million but, given the share price, I have calculated the fair value as $42 million. I thought that equity investments that weren't consolidated needed to be measured at fair value. Please explain:

1. Why we aren't including Sandy as a subsidiary in our consolidated financial statements.
2. What method will have been used to arrive at the carrying amount of $40 million rather than measuring the investment at fair value.

(9 marks)

New investment

Under the principles of IFRS 10 – *Consolidated Financial Statements* – Sandy would be a subsidiary if we were in a position to control its operating and financial policies.	1
In this case, whilst the investment is long term and substantial, it does not give us control, so consolidation is inappropriate.	1
Under the principles of IAS 28 – *Investments in Associates and Joint Ventures* – the 40% shareholding in Sandy, being **greater than 20%**, would be presumed to give us **significant influence** over the operating and financial policies of Sandy.	1 + 1
Given the fact that we are **able to appoint four of the ten members of Sandy's board of directors, and there is no evidence that the other shareholders or board members are acting in concert to prevent us from exercising this influence**, then the presumption of significant influence **would** appear to be appropriate in this case.	1 + 1
Therefore IAS 28 would regard Sandy as an associate.	1
IAS 28 requires that investments in associates are measured using the **equity method. This method initially measures the investment at cost, but then adjusts the carrying amount by the investing entity's share (40% in this case) of the post-acquisition change in net assets of the investee entity (Sandy in this case)**. This amount is **not necessarily** the same as the fair value of the investment at any given date.	½ + 1 + ½
	9

Note 3

The draft financial statements indicate that in the current period we began measuring our inventory of raw materials using the weighted average cost formula. In previous periods we measured all our inventories using the first in first out formula. I have a number of questions here:

1. Are we allowed to change the measurement method in this way?
2. If we do change the measurement method for our inventory of raw materials shouldn't we change it for all of our inventories?
3. How do we ensure that the financial statements for this year are comparable with those of last year given that a different measurement method has been used for raw materials inventory?

(8 marks)

Requirements

You are the financial controller of Epsilon, a listed entity with a number of subsidiaries. The consolidated financial statements of Epsilon for the year ended 31 March 20X5 are currently being prepared. One of the directors of Epsilon has raised some queries which have arisen as a result of her review of the draft consolidated financial statements.

The following **exhibits**, available on the left-hand side of the screen, provide information relevant to the question:

1. New subsidiary – the financial statements of Newby.
2. Investment – details of an equity investment.
3. Measurement change – details of a change in measurement method of inventory.

This information should be used to answer the question **requirements** within the **response option** provided.

Measurement change

The decision to measure raw materials inventory using the weighted average cost formula rather than the first in first out formula represents a **change in accounting policy**. This is because it represents a change in the principles under which assets are measured. 1

Under the principles of IAS 8 – *Accounting Policies, Changes in Accounting Estimates and Errors* – accounting policy changes **are** appropriate if the new policy would result in the financial statements providing **reliable and more relevant information about the effects of transactions, other events or conditions on the entity's financial position, performance of cash flows**. ½ +1

Under the principles of IAS 2 – *Inventories* – decisions about the more relevant measurement formula for inventories are made for categories of inventory having a similar nature and use to the entity. Raw materials inventory would be regarded as having a different nature and use to other types of inventory, **so it is theoretically appropriate that they could be measured using the weighted average cost formula whilst other types of inventory are measured using the first in first out formula**. 1 + 1

Where an entity changes its accounting policies in any financial period, comparability is ensured by **re-stating** prior year figures which are presented as comparatives. The comparatives are presented as **they would have been had the previous financial statements been presented using the new accounting policy**. ½ + 1

The difference between the opening and closing equity as presented in the previous year's financial statements and the equivalent figures measured using the new accounting policy is shown as an adjustment to the opening equity for the current period and the opening equity in the previous period. These differences are presented in the statement of changes in equity (and its comparative) and do not affect reported profit or loss. (exact wording not required – up to) 2

8

Dec 2021

Q2:

Exhibit 2 Construction of Power Plant:

On 1 November 20X4, Gamma commenced the construction of a power plant. The total cost of constructing the power plant was $30 million. Gamma completed the construction of the power plant on 28 February 20X5 and began to use the power plant on 31 March 20X5. The estimated useful life of the power plant is 20 years from the date it is first depreciated.

The construction of the power plant caused a certain amount of environmental damage. The directors of Gamma estimate that, should the damage be rectified at the end of the useful life of the power plant, the cost of this rectification work would be $20 million. There are no legal requirements for such work to be carried out in the jurisdiction in which Gamma operates. However, in the past whenever Gamma has caused environmental damage by its business processes, the company has always rectified the damage, whether or not legally required to do so.

An appropriate discount rate to use in any discounting calculations is 8% per annum. Using this rate at 28 February 20X5, the present value of $1 payable in 20 years' time is approximately 21 cents.

The finance director has discussed the preparation of the financial statements with you. He has requested you not to include any of the implications of the environmental damage in the financial statements for the year ended 30 September 20X5. He has stated that Gamma plans on paying a profit-related bonus to all employees for the year ended 30 September 20X5. He said to you, 'I feel sure you agree with me that we need to report as healthy a profit as possible to ensure our efforts are rewarded with an appropriate bonus.'

(b) Using the information in exhibit 2, identify and explain the ethical threats you face as a result of your discussion with the finance director. Your explanation should refer to relevant fundamental ethical principles.

(4 marks)

(b) The situation that the financial controller has been presented with means that the fundamental principles of **objectivity** (not to compromise professional judgements because of conflict of interest or undue influence) and **professional competence and due care** (acting diligently and in accordance with IFRS standards – in this case IAS 37) are under threat.

The discussion with the finance director means that the financial controller faces a **self-interest threat**. This is because the financial controller is due to receive a bonus based on the reported profit for the period. Therefore there is a potential inducement to prepare the financial statements in such a way that reported profit is maximised. Inclusion of an environmental provision would lead to a finance cost and additional depreciation, both of which would depress reported profits.

In addition to a self-interest threat, the financial controller would also face an **intimidation threat**. This is because the financial controller reports to the finance director and would therefore be accustomed to following his directives. It would be difficult to avoid doing this even if these directives were apparently in breach of fundamental ethical principles.

Exhibit 1 Conceptual Frame Work:

One of the presenters at the seminar I attended was explaining the work of the International Accounting Standards Board (the Board). From time to time she referred to the *Conceptual Framework for Financial Reporting*. I thought the Board set individual international financial reporting standards (IFRS Standards) to deal with specific issues of financial reporting. What is this '*Conceptual Framework*' and how does it relate to individual IFRS standards issued by the Board? I don't want a detailed description of this *Conceptual Framework* but rather a very brief overview of its content and purpose and how it fits into the overall financial reporting process.
(8 marks)

Conceptual Framework

The *Conceptual Framework* (*Framework*) is a document which sets out the **objectives** and **concepts** for general purpose financial reporting. The *Framework* provides the foundations for the International Financial Reporting Standards (IFRS Standards) but it is not a standard itself. 1 + ½

These concepts are set out in a number of **distinct chapters** in the document. These chapters address issues **such as** the overall objective of general purpose financial reporting which is to provide financial information which is useful to existing and potential investors, lenders and other creditors. A further chapter details the qualitative characteristics of useful financial information. ***(Other examples of chapter titles up to 1 mark would be acceptable – the question makes clear that only a general overview is needed)*** ½ + 1

A key purpose of the *Framework* is to **assist the International Accounting Standards Board (the Board) in developing** and revising individual IFRS Standards which are based on consistent concepts. Therefore the **concepts underpinning any specific IFRS Standard should generally be consistent** with those outlined in the *Framework*. ½ + ½

The *Framework* does not override the provisions of any specific IFRS Standards. In the rare circumstances that the Board decided to issue a new or revised standard which is in conflict with the *Framework*, the Board would highlight the fact and explain the reasons for the departure in the Basis for Conclusions to the standard. (up to) 2

A further purpose of the *Framework* is to help preparers to develop consistent accounting policies for areas which are **not covered by a IFRS Standard (e.g. cryptocurrency)** or where there is choice of accounting policy, and to **assist all parties to understand and interpret IFRS Standards**. 1 + 1

Exhibit 2 Brand Names:

One of the topics covered during the seminar was a discussion on whether brand names should be included as assets in the financial statements. I looked at our consolidated financial statements and noticed the disclosure note for intangible assets included a separate heading 'Brands'. The finance director has provided me with an analysis of this figure, and it all relates to brands acquired through the acquisition of subsidiaries. However, the Omega brand name itself was not included at all. Surely this is inconsistent – the Omega brand name is associated with well known and popular products developed by Omega. This brand name is probably as valuable as the brand names associated with the subsidiaries we've acquired in recent years. I thought financial statements had to be consistent in their treatment of items. Please explain this apparent inconsistency to me. Please also explain how brand names which are recognised on acquisition are measured and whether they should be amortised.

(11 marks)

Brand names

A brand name is an intangible asset and so the recognition and measurement requirements are to be found in IAS 38 – *Intangible Assets*.	½
IAS 38 states that the recognition of brand names (and other intangible assets) in the statement of financial position depends on **how they arose**. Brand names which are **purchased** can be recognised as assets.	½ + ½
Where a brand name is purchased in an individual transaction, then the brand name can be recognised at its original purchase cost.	1
When a parent company acquires a subsidiary company, the purchase consideration needs to be allocated to the individual assets and liabilities which are to be included in the consolidated statement of financial position. Any amount of the consideration which cannot be allocated is presented as goodwill on acquisition.	(overall principle, however worded) 1
A brand name acquired as part of the acquisition of a subsidiary can be recognised as an asset in the consolidated financial statements if it is **identifiable**. This **means** that the asset is either capable of being sold separately or arises from contractual or other legal rights, regardless of whether or not these rights are transferable. This is **even if** it is not recognised in the individual financial statements of the subsidiary.	(sense of the point) ½ + 1 + ½
Where a brand name associated with the acquisition of a subsidiary is regarded as identifiable, then it is initially recognised at its **fair value at the date of acquisition**.	½
The brand name associated with Omega itself (the parent company) is an internally developed intangible asset from the perspective of Omega.	(principle) ½
Unless internally developed intangibles relate to the cost of developing a specific product or process, they cannot be recognised as assets because their 'cost' cannot be established reliably. This explains why brand names associated with acquired subsidiaries can be recognised in the consolidated financial statements but the Omega brand name cannot.	(sense of the point) 1 + (conclusion) ½
Brand names which are recognised should be included as intangible assets and written off (amortised) over their estimated useful lives.	1
Where the useful lives of brand names are assessed as being **indefinite**, then **no** amortisation charge is necessary but the brand name needs to be reviewed for possible impairment at the end of **every** financial reporting period, **irrespective** of whether or not indicators of impairment are present.	½ + ½ + ½ + ½
	11

Exhibit 3 Segment Reporting:

The seminar referred to the need for companies to provide information about the financial performance and financial position of different segments of their business in a note to their financial statements. They provided an example of the disclosures provided by a listed entity of a similar size to Omega. On returning from the seminar, I compared the segmental disclosures we had been shown with the segmental disclosures which Omega makes. The way Omega identifies and discloses segmental information was totally different from the seminar example. How can this be right – I thought financial statements needed to be prepared on a consistent basis?

I also looked at the financial statements of one of our key competitors. This competitor is an unlisted family run business which has grown very rapidly and is now not much smaller in size than the Omega group. They operate in the same economic sectors as we do. However, their financial statements make no segmental disclosures. Please explain how not applying the segmental reporting requirements is acceptable when this company is preparing the financial statements using IFRS Standards.

(6 marks)

Segment reports

The issue of segmental disclosures is addressed in IFRS 8 – *Operating Segments*. IFRS 8 requires that segmental disclosures are made with reference to key operating segments of the business. (overall sense of the point) 1

IFRS 8 says that an operating segment is one which **earns revenues** and incurs expenses, whose results are regularly reviewed by the **chief operating decision maker** and for which **discrete financial information** is available. ½ + ½ + ½

The term 'chief operating decision maker' is a role, not a manager with a specific title. The function is to assess performance and allocate resources. This role is often undertaken by the chief executive officer but there could be circumstances where the role is undertaken by a group of directors.

The segments which are reported are identified because:

(i) They exceed quantitative thresholds set out in IFRS 8; and

(ii) It will allow users of the financial statements to evaluate the nature of the business activities and the economic environment in which it operates (nature of the products, the production processes, type of customer, distribution methods, regulatory environment). 2

Given that different entities could organise themselves in different ways, the operating segments which are identified and reported could theoretically differ between apparently similar entities. (conclusion) ½

IFRS 8 only applies to listed entities, so a large unlisted family business would not be required to given segmental disclosures. 1

June 2022

Gamma prepares financial statements to 31 March each year. You are a trainee accountant employed by Gamma and report to the finance director (FD) of Gamma. One of your key responsibilities is to prepare the first draft of Gamma's published financial statements. You have recently received an email from the FD regarding the financial statements for the year ended 31 March 20X5 but are unsure how to respond. You would like to ask the advice and assistance of a friend who is a fully ACCA qualified accountant with more technical knowledge, but they are not employed by Gamma.

The following **exhibits**, available on the left-hand side of the screen, provide information relevant to the question:

1. Email – an email from the finance director.
2. Attachment 1 to the email – provides details relating to shares granted to ten of Gamma's executives.
3. Attachment 2 to the email – details the revaluation of property.

This information should be used to answer the question **requirements** within your chosen **response option(s)**.

1. Email

Page: 1 of 1 150%

To: Trainee accountant
From: Finance director
Subject: Potential bonuses dependent on performance
Date: 5 April 20X5

It is very important that the upcoming set of financial results of Gamma show a favourable financial performance and position. If the results are good, then potentially there are big bonuses available for all staff, including you! There are a couple of complex transactions which have occurred in the year ended 31 March 20X5 which you may be unsure how to deal with in your preparation of the draft financial statements. They are set out in the two attachments to this email. I have also included the way in which I would like you to deal with them in your draft. I have tried to identify treatments which will show Gamma in as favourable a position as possible.

2 Attachment 1 to email

The relevant standard is IFRS 2 – *Share-based Payment*. Under IFRS 2, the offer of shares to senior executives is a share-based payment transaction which must be recognised in the financial statements (*principle*).

This particular transaction (a share-based payment transaction with a cash alternative) is treated partly as an equity settled share-based payment transaction and partly a cash settled one (*principle*).

The fair value of the equity settled element at the grant date is computed by deducting the fair value of the cash alternative at the grant date from the overall fair value of the offer of the shares with the cash alternative (*exact words not necessary – principle*). This is because the executives (counterparty) and not the entity have the choice as to whether to take the shares or cash.

The fair value of the equity settled part of the transaction is $72,000 [12,000 x $9 (the fair value of the overall share offer) x 9 executives – 10,000 x $10 (the fair value of the cash alternative) x 9].

The equity settled part of the arrangement is recognised as a remuneration expense over the three-year vesting period based on its fair value at the grant date and the number of shares which are actually expected to vest (*principle*).

Therefore the amount which is recognised in the year ended 31 March 20X5 is $24,000 ($72,000 x 1/3).

The corresponding credit entry in the statement of financial position is to other components of equity and will not be re-measured.

The remuneration expense associated with the liability component of the arrangement is also recognised over the vesting period and based on the number of shares which are actually expected to be issued on vesting. However, the expense is measured based on the fair value of the liability component at the reporting date (*principle*).

Therefore the total amount which is recognised in profit or loss as a remuneration expense in the year ended 31 March 20X5 is $384,000 = ((9 x 10,000 x $12 x 1/3) = $360,000 + $24,000 [above]).

The corresponding credit entry of $360,000 in the statement of financial position is to non-current liabilities.

Tutorial note: *Candidates may present as a journal:*

DR Profit or loss – Remuneration expense	*$384,000*	
CR Non-current liability		*$360,000*
CR Other components of equity		*$24,000*

2. Attachment 1 to the email

Page: 1 of 1 Automatic Zoom

On 1 April 20X4, we granted ten of our senior executives 12,000 shares each in Gamma. These shares will vest on 31 March 20X7 provided the executives remain employed by Gamma until then. One of these executives is likely to retire in the next couple of years but the other nine are almost certain to stay employed until at least 31 March 20X7. The shares will be issued on 31 March 20X7. As an alternative to receiving the 12,000 shares, each executive could, on 31 March 20X7, receive a cash payment equal to the value of 10,000 shares on that date.

The market price of Gamma shares on 1 April 20X4 was $10 per share and this has increased to $12 by 31 March 20X5. My finance specialists tell me that the fair value of the share alternative was $9 on 1 April 20X4, increasing to $9·50 by 31 March 20X5.

Do not worry about all this detail as although we have given them the choice, the executives are almost certain to take up the shares rather than the cash, so all we need to do is to recognise the share issue when it happens on 31 March 20X7. Therefore, you do not have to include this in the financial statements until then.

(10 marks)

Attachment 2 to email

The relevant standard is IAS 16 – *Property, Plant and Equipment* (PPE). Where PPE is revalued and the revaluation shows a surplus, then, unless the surplus is eliminating a previous revaluation deficit on the same asset, the surplus is recognised in other comprehensive income rather than profit or loss (*principle*).

Since this is a first time revaluation, then a surplus of $10 million ($30 million – $20 million) will be recognised in other comprehensive income.

Regardless of future potential increases in value, assets which are revalued still need to be depreciated over their estimated future useful lives (*principle*).

Land generally has an indefinite life, so only the buildings element of the property needs to be depreciated (*principle*).

This means that the depreciation charge on the property for the year ended 31 March 20X5 will be $0·9 million ($18 million x 1/20). $0·9 million will be charged as an expense in the statement of profit or loss.

The carrying amount of the property at 31 March 20X5 will be $29·1 million ($30 million – $0·9 million). This will be presented as part of non-current assets in the statement of financial position.

Under the principles of IAS 12 – *Income Taxes* – a deferred tax liability must be recognised on the revaluation of an asset even if there is no intention to dispose of the asset (*principle*).

IAS 12 requires that a deferred tax liability be recognised on the difference between the carrying amount of an asset and its tax base (*principle*).

So for this property, the deferred tax liability prior to its revaluation will be $5 million (25% x $20 million (– $0 tax base)).

After the revaluation, the deferred tax liability will increase to $7·5 million (25% x $30 million (– $0 tax base)).

The increase of $2·5 million following the revaluation will be debited to other comprehensive income.

The net credit to other comprehensive income as a result of the revaluation will be $7·5 million ($10 million – $2·5 million). This net credit will be recognised as a revaluation surplus in the statement of financial position as part of 'other components of equity'.

The deferred tax liability on 31 March 20X5 will be $7·275 million ($29·1 million x 25%). This will be presented as a non-current liability in the statement of financial position.

The reduction in the deferred tax liability between 1 April 20X4 and 31 March 20X5 will be $0·225 million ($7·5 million – $7·275 million). This will be shown as a credit to the income tax expense in the statement of profit or loss.

Tutorial note: *Some candidates may mention the option given in IAS 16 for entities which measure PPE using the revaluation model to make a transfer between the revaluation surplus and retained earnings. This transfer is based on the difference between depreciation actually charged on the revalued asset – in this case $0·9 million – and the depreciation which would have been charged had the asset continued to be measured at historical cost. This amount would have been $0·5 million ($10 million x 1/20), so the gross transfer for the year ended 31 March 20X5 would have been $0·4 million ($0·9 million – $0·5 million). Where deferred tax is taken into consideration, the transfer is made net of attributable taxation. The accounting entry in this case would be:*

	$m	*$m*
Credit retained earnings ($0·4 million x (100 – 25)%)		*0·30*
Debit revaluation reserve	*0·30*	

Candidates who take this approach will be awarded a maximum of 3 additional marks (but the total for attachment 2 cannot exceed 10 marks).

Email from finance director (FD)

You are in danger of breaching the fundamental ethical principle of objectivity. You have a personal interest in reporting a favourable profit because of the possibility of a profit related bonus.

You also may be breaching the fundamental ethical principle of professional competence. As only part qualified and only part-way through a training programme, you may well not be competent enough to make a decision on the complex transactions outlined by the FD.

You are also breaching the fundamental ethical principle of integrity. It is at least possible that the FD is deliberately seeking to falsify the financial statements. If you are complicit and comply with the instructions of the FD, then there is a danger that this principle will be breached.

It is not appropriate to reveal the detail in the attachments to that email to a friend who is not employed by Gamma. This clearly breaches the fundamental ethical principle of confidentiality.

3. Attachment 2 to the email

Page: 1 of 1 Automatic Zoom

I want to measure Gamma's property at its market value from the start of the year (1 April 20X4). Gamma has not used the revaluation model before. The property was previously recognised in the financial statements on 1 April 20X4 at its carrying amount of $20 million. $10 million of this amount relates to the land element of the property and $10 million to the buildings element. A report from a qualified surveyor has indicated that its market value on 1 April 20X4 was $30 million. The report said that $12 million of this value was attributed to the land element and $18 million to the buildings element. The profit on revaluation will improve our reported pre-tax profit and provide a nice improvement to financial performance this year. It is likely the company will use this property for 20 more years from 1 April 20X4 but do not worry about accounting for depreciation – future increases in value of the property will be more than enough to cancel depreciation out.

If we sold the property, we would have to pay tax at 25% on any profit made. The tax department has informed me that the tax base of the property on 1 April 20X4 was nil because the property qualified for very favourable tax treatment when purchased. You need not worry about any of this though; we have no immediate intention of disposing of this property, so we can leave tax considerations related to the revaluation until later.

(10 marks)

3 Exhibit 1 – Post-employment benefit plans

The relevant standard to apply here is IAS 19 – *Employee Benefits*. Since the benefits payable to plan A members are dependent on the value of the investment fund, plan A is a defined contribution plan.

This means that the liability of Delta is limited to the payment of contributions into the plan. Delta has no responsibility for the adequacy of the plan or payments to the former employees.

Therefore the contributions payable by Delta for the period of **$45 million** will be shown as an **employment expense in the statement of profit or loss**. The current service cost is irrelevant to the financial reporting of amounts relating to a defined contribution plan.

The benefits paid to the former employees are paid by the plan and so are not relevant to Delta. Neither is the fair value of the plan assets.

Since the benefits payable to plan B members are based on final salary and length of service of the relevant employee, plan B is a defined benefit plan.

This means that the difference between the present value of the obligation (the liability of the plan to pay future benefits) and the fair value of the plan assets is reflected in the statement of financial position of Delta as a net liability or a net asset (*principle*).

Therefore the statement of financial position of Delta will record a net liability of **$55 million** ($220 million – $165 million) at 31 March 20X5. This will be shown as **a non-current liability**.

Since there is no guarantee that the contributions payable to the plan will be sufficient to fund the benefits, it is the current service cost which is shown as an operating expense in the statement of profit or loss (***principle***). In this case, the relevant expense is **$14 million**.

Since, for plan B, Delta has a constructive obligation to fund any deficits, it is appropriate to recognise a net interest cost in the statement of profit or loss. This is the net of the interest cost on the liability and the interest income on the assets (***principle*** – *just sense of the point rather than the exact words*).

In this case, the net interest cost would be $3·4 million ($14·84 million (W1) – 11·44 million (W1)).

The benefits paid to the former employees are paid by the plan and so are not relevant to Delta.

The liability of the plan to pay future benefits is an estimate which is usually computed with reference to actuarial advice. This means that there will almost always be a difference between the net closing liability/asset after accounting for the other movements recognised in the financial statements and the actuarial valuations at the year end of the plan assets and liability (***principle*** – *just sense of the point rather than the exact words*).

This difference is referred to in IAS 19 as an **actuarial gain or loss** and is recognised in **other comprehensive income**.

In this case, the actuarial loss is $2·6 million (W2).

Working 1 – Net interest cost – plan B

	Asset $'000	Liability $'000
Opening balance	140,000	(190,000)
6/12 of the contributions of $15,000 to plan in the period (increasing the asset)	7,500	
6/12 of the benefits of $9,000 paid to employees in the period (reducing both the asset and the liability)	(4,500)	4,500
Average carrying amount of asset and liability in the period	143,000	(185,500)
Interest at 8%	11,440	(14,840)

Working 2 – Actuarial gain or loss – plan B

NB numbers below in $'000

	$'000
Opening net liability (190,000 – 140,000)	(50,000)
Current service cost	(14,000)
Net interest cost (W1 (14,840) less 11,440) – NB: OF rule applies here	(3,400)
Contributions payable by Delta into plan	15,000
Actuarial (loss)/gain – **balancing figure**	(2,600)
Closing net liability (220,000 – 165,000)	(55,000)

Requirements (25 marks)

(a) Using the information in exhibits 2 and 3, explain and show how the transactions described should be accounted for in the financial statements of Gamma for the year ended 31 March 20X5. Your answer to (a) should NOT include discussion of any ethical issues.

(20 marks)

Notes:

- The mark allocations are indicated in each exhibit.
- Marks will be awarded for BOTH figures AND explanations.

(b) Using the information in exhibit 1, explain THREE ethical issues confronting you as a result of the email from the finance director and the associated attachments and whether you should ask for assistance from your fully ACCA qualified friend who is not employed by Gamma.

(5 marks)

1. Acquisition of subsidiary

As you know, we acquired a controlling interest in NewSub on 30 September 20X4. NewSub is currently unlisted and has two separate business segments which will complement the activities of our existing group very well. I have been examining the most recent published financial statements of NewSub which are prepared using full IFRS Standards. There are a few things that I do not understand about these financial statements and I would appreciate your help.

Query 1

The most recent published financial statements of NewSub are for the year ended 31 December 20X4. Given that the Omega group year end is 31 March, this seems to pose a problem when preparing the consolidated financial statements. How do we incorporate the NewSub results given that they are prepared to a different year-end date? Could we require NewSub to change its year end, given we now control the company?

Query 2

A key reason for my reviewing NewSub's published financial statements was to find out how revenues and profits are split between its two business segments. I have found the segmental reports which we include in our consolidated financial statements very useful when considering the performance of the business segments of our existing group. However, when I examined the financial statements of NewSub, I found none of the segment disclosures that I see when I review the consolidated financial statements of Omega. How can NewSub's financial statements be in accordance with full IFRS Standards without this information? Does NewSub's lack of segmental reporting mean we can ignore segmental reporting for NewSub in our consolidated financial statements for the year ended 31 March 20X5?

Query 3

I have noticed that NewSub has some investment properties. A note to NewSub's financial statements states that these properties are measured using the cost model. I believe that the Omega group policy is to measure investment properties using the fair value model. This is in line with full IFRS Standards, so the NewSub policy must be wrong. On that basis, how should we deal with the investment properties of NewSub in the consolidated financial statements of Omega? Now that we control NewSub, should we require NewSub to change its accounting policy in its own individual financial statements?

(17 marks)

4 Exhibit 1

Query 1

IFRS 10 – *Consolidated Financial Statements* – deals with the procedures to be followed when preparing such statements (*principle*).

IFRS 10 states that the financial information relating to any subsidiary entity should normally be prepared to the same reporting date as the reporting date of the parent entity (*principle*).

Where a subsidiary has a reporting date which differs from that of the parent, then it is normally necessary to prepare additional financial information relating to that subsidiary as of the same date as the reporting date of the parent (*principle*).

If this is not practicable, then IFRS 10 allows the parent to prepare consolidated financial statements which incorporate financial information for the subsidiary drawn up to the most recent reporting date of the subsidiary (*principle*).

In such circumstances, IFRS 10 requires adjustments to be made for 'significant' transactions which occur between the reporting date of the subsidiary and the reporting date of the parent (*principle*).

The above facility is only possible where the reporting dates of the subsidiary and the parent differ by three months or less (*principle*).

Therefore it would be possible to use the financial statements of NewSub for the year ended 31 December 20X4 to prepare the consolidated financial statements of Omega for the year ended 31 March 20X5 (*conclusion*).

There is no requirement for NewSub to change its year end following its acquisition by Omega but this might make the consolidation process more straightforward in the future (*sense of the point*).

Query 2

Segmental disclosures are required by IFRS 8 – *Operating Segments*.

IFRS 8 only applies to listed entities, so it is not necessary for NewSub to give such disclosures in its own individual financial statements.

Given that NewSub is now part of the Omega group, then disclosures relating to its operating segments would be required in theory in the consolidated financial statements of Omega.

In practice, the operating segments of NewSub would need to meet the criteria for them to be reportable in the consolidated financial statements of Omega (*sense of the point*).

These criteria are that the operating segments would be regularly reviewed by the Omega group management (chief operating decision maker) and they are material in the context of the Omega group.

In this context, 'material' means that the reported revenues, profits or assets of the segment are 10% or more of the combined reported revenues, profits or assets of all of the operating segments of the Omega group, i.e. exceeds the quantitative thresholds in IFRS 8.

Notwithstanding the quantitative thresholds, however, IFRS 8 permits entities to disclose information about operating segments if, in the judgement of management, such information would be useful to users.

Query 3

Accounting for investment properties is set out in IAS 40 – *Investment Property*.

IAS 40 states that investment properties are initially accounted for at cost (*principle*).

IAS 40 allows an accounting policy choice for subsequent measurement of investment properties.

IAS 40 allows either the cost model or the fair value model but requires a consistent choice of measurement model for all investment property.

On the date when Omega acquires NewSub, the 'cost' of NewSub's investment properties from the perspective of the consolidated financial statements would be their fair value at the date of acquisition of NewSub.

This means that, for the purposes of the Omega group consolidation, NewSub's investment properties will need to be measured using the fair value model. This will require on-going adjustments to be made at group consolidation level.

It is not necessary for NewSub to adjust its accounting policy in its own financial statements but for practical purposes this might be the preferred option going forward (*sense of the point*).

2. Financial statements

Page: 1 of 1 Automatic Zoom

I thought it would be useful for me to review the consolidated financial statements of Omega for the year ended 31 March 20X4 to help me to assess those prepared for the year ended 31 March 20X5. I also looked at the financial statements of one of our key competitors, Rival. I have the following questions concerning the statements of profit or loss and other comprehensive income of Omega and Rival.

Query 1
I can see similarities between the statements for Omega and Rival. Both show revenue, finance costs, profit before tax, and income tax expense on the face of the statement. However, many of the other line items in the statements seem to be totally different. In particular, the classification of operating expenses into various categories in the Omega statement is completely different from the classification in the Rival statement. How can this be when both statements are allegedly prepared in accordance with full IFRS Standards?

Query 2
I am not clear how you decide which items are shown in the 'profit or loss' section and which are shown in the 'other comprehensive income' section. Are entities allowed a free choice in this matter and would it change how performance might be assessed?

(8 marks)

Requirement (25 marks)

Provide answers to the queries raised by one of Omega's directors detailed in exhibits 1 and 2, relating to the consolidated financial statements for the year ended 31 March 20X5.

Note: The mark allocations are indicated in each exhibit.

(25 marks)

Exhibit 2 – Statement of profit or loss and other comprehensive income

Query 1

The overall requirements for presentation of financial statements are set out in IAS 1 – *Presentation of Financial Statements* (*principle*).

IAS 1 requires that the statement of profit or loss and other comprehensive income discloses certain key elements, for example, revenue and income tax expense (*principle*).

As far as other detailed line items are concerned, IAS 1 states that they should be presented in a manner that is relevant to an understanding of the financial performance of the reporting entity (*principle*).

Query 2

As far as the allocation of items between profit or loss and other comprehensive income is concerned, IAS 1 states that all items of income and expense should be presented in profit or loss unless another IFRS standard requires or permits otherwise (*principle*).

There is no theoretical distinction between 'profit or loss items' and 'other comprehensive income items'. However, it is more likely for gains, rather than losses, to be recognised in other comprehensive income (for example, revaluation gains on re-measurement of property, plant and equipment are usually recognised in other comprehensive income whereas revaluation losses are unusually recognised in profit or loss).

Gains or losses which are recognised in profit or loss contribute to the computation of earnings per share (EPS). Those recognised in other comprehensive income do not.

EPS is a key performance indicator for listed entities which must be disclosed in the published financial statements.

This would therefore matter for both Omega and Rival (*conclusion*).

		Marks
4	**Exhibit 1**	
	Query 1:	
	– IFRS 10 principles	3
	– Application to NewSub	3
	Query 2:	
	– IFRS 8 principles	3
	– Application to Omega	2
	Query 3:	
	– IAS 40 principles	3
	– Application to NewSub/Omega	3
		17
	Exhibit 2	
	Query 1:	
	– IAS 1 principles	2
	– Application	1
	Query 2:	
	– Explanation profit or loss v other comprehensive income	3
	– Impact on performance indicator	1
	– Application to Omega	1
		8
		25

Dec 2022

As you know, we acquired a new subsidiary during the year ended 30 September 20X4. This subsidiary operates several different farms, which contain both cattle and sheep. We dealt with all the initial consolidation procedures last year and I understand how all of that works. However, I am not sure how we have measured the assets of this subsidiary at 30 September 20X5. I thought that assets were generally measured based on what they cost. I understand how that would work for this subsidiary in the case of the purchase of farm machinery, or the purchase of cattle or sheep from the market. I am not clear, though, how you would measure the cattle and sheep subsequently born on the farm as there is no cost of purchase. The same would apply to inventory items like meat or milk. Please explain how we measured the assets of this subsidiary in its statement of financial position. When do profits and losses relating to farming assets get recognised, given that there is often no real 'cost' of acquisition?

(12 marks)

Exhibit 1 – Assets of subsidiary

IAS 41 ***Agriculture*** deals with **agricultural activity**. Agricultural activity is the management by an entity of biological transformation and harvest of biological assets for sale or conversion into agricultural produce or into additional biological assets.

A biological asset is a living plant or animal. Cattle or sheep are examples of biological assets.

Agricultural produce is the harvested produce of biological assets. Both milk and meat are examples of agricultural produce.

Therefore IAS 41 applies to many of the assets of our farming subsidiary (conclusion).

IAS 41 states that biological assets should normally be measured at fair value less costs to sell in the statement of financial position on initial recognition and at each year end.

Where cattle or sheep are purchased at a market, this means a reliable fair value and related costs can be used to arrive at initial recognised costs and any subsequent increase/decrease at the year end.

In the case of newly born cattle or sheep, the same 'fair value less costs to sell' principle applies.

A gain or loss arising on initial recognition or arising from a change in fair value less costs to sell at the year end are included in profit or loss.

This means that there is immediate recognition of a gain (equal to fair value less costs to sell) in profit or loss as the relevant biological asset is recognised when cattle and sheep are newly born.

IAS 41 does allow the 'cost model' to be used for biological assets if fair values cannot be measured reliably but this is unlikely to be true for biological assets like cattle or sheep where market values are available.

IAS 41 states that agricultural produce should be measured at its fair value less costs to sell at the point of harvest (principle).

IAS 41 defines 'harvesting' as the detachment of produce from a biological asset (for example, the milking of a cow) or the cessation of a biological asset's life processes (for example, the slaughter of a cow or a sheep for its meat).

The initial recognition of agricultural produce in the statement of financial position is likely to lead to an equal gain being recognised in the statement of profit or loss.

From this point on, agricultural produce would be subject to the recognition and measurement requirements of IAS 2 – *Inventories*.

Profits or losses on the subsequent sale of agricultural produce would be recognised when such produce was actually sold.

Other assets of our farming subsidiary (for example, farmland, farm machinery or trade receivables) would be measured using the IFRS standards relevant to their nature.

At our board meeting, the finance director provided us with a summary of three events which had occurred in the period immediately after 30 September 20X5. These were:

1. The settlement of a legal case which a former employee had brought against one of our subsidiaries. The case was in respect of alleged unfair dismissal on 31 December 20X4. At 30 September 20X5, our legal team estimated that the case was likely to result in our paying $500,000 to this employee. On 20 October 20X5, the case was settled, and the subsidiary was required to pay $560,000, including court costs.
2. A fire at one of the factories of another subsidiary on 11 October 20X5. This fire caused damage which is likely to cost $2 million to rectify. The subsidiary does have the necessary resources to finance this work. There was no insurance in place to cover this cost.
3. The launch of a new product on 10 November 20X5 by a competitor. This product is likely to provide significant competition to one of the key products of another subsidiary. As the subsidiary may need to reduce its selling prices, estimates suggest the net realisable value of the inventories of this subsidiary at 30 September 20X5 could be $250,000 lower than its cost.

I'm a little confused about how these events should have been reflected in the financial statements for the year ended 30 September 20X5. I know that the group financial statements were authorised for issue on 31 October 20X5. Please explain the appropriate treatment of each item in our financial statements.

(8 marks)

Exhibit 2 – Post year end

There is an IFRS standard, **IAS 10** *Events after the Reporting Period* which deals with this issue. IAS 10 defines an event after the reporting date as one occurring between the reporting date and the date the financial statements are authorised for issue.

IAS 10 further classifies events after the reporting date into adjusting and non-adjusting events (principle).

An adjusting event is one which provides **additional evidence of conditions existing at the reporting date**. The first event you have queried is **an example of an adjusting event because** it provides confirmation of the amount of a liability which existed at the reporting date (since the unfair dismissal occurred on 31 December 20X4, prior to the year end).

IAS 10 requires that the impact of adjusting events be recognised in the financial statements (principle). This means **that we should recognise a liability of $560,000 in the statement of financial position at 30 September 20X5 in respect of this case** and an expense of $560,000 in the statement of profit or loss for the year. We should also make **additional disclosures** if this would assist the users of the financial statements.

Non-adjusting events are those events and transactions which provide additional evidence of conditions which arose **after** the reporting date. The fire at the factory is an example of a non-adjusting event.

Non-adjusting events should not be recognised in the financial statements, but should be fully disclosed in the notes to the financial statements if material.

The only exception to the 'non-recognition' rule mentioned above is if the event would be likely to impact on the going concern status of the reporting entity. This exception does not apply here because the subsidiary has the resources to finance the cost of rectifying the fire damage.

The third event you mentioned is **not an 'event after the reporting date' in accordance with IAS 10** as far as our latest financial statements are concerned because it occurred after the financial statements had been authorised for issue. The impact of this event will be shown in the **financial statements for the year ended 30 September 20X6**.

On 1 August 20X5, Omega bought some inventory from a supplier based in a country whose currency is the groat. The invoiced amount was 840,000 groats. Omega paid for the goods on 31 August 20X5. Omega sold these goods to customers based in that country during October 20X5 for 1 million groats, and it looks like we made a healthy profit on the sale of those goods after the year end. I am unsure how this transaction would have been recognised in the financial statements for the year ended 30 September 20X5, given that the financial records of all of our group companies are prepared in $ and the exchange rate has changed throughout the period of this transaction (see the table below). Please explain the appropriate financial reporting treatment to me.

Table of exchange rates

Date	**Exchange rate (groats to $1)**
1 August 20X5	6
31 August 20X5	7
30 September 20X5	8

(5 marks)

Exhibit 3 – Purchase of inventory from a foreign supplier

This purchase is dominated in another currency and so is a foreign currency transaction. The accounting treatment for such transactions is set out in IAS 21 *The Effects of Changes in Foreign Exchange Rates*.

IAS 21 states that foreign currency transactions should initially be recorded at the rate of exchange in force when the transaction occurred (**principle**). This means that, in this case, an **inventory and a payable of $140,000** (840,000/6) would be recorded.

The payable is settled on 31 August 20X5. The cash required to settle the payable would have been $120,000 (840,000/7).

This means that an exchange gain of **$20,000** (140,000 – 120,000) would be recognised in the **statement of profit or loss**.

The closing balance of inventory would have a cost of **$140,000**. This is **because** the inventory measured at cost is a non-monetary item (i.e. it is not expressed in terms of a monetary amount receivable or payable) and is not retranslated at the year end.

IAS 2 – *Inventories* – requires that inventories be measured at the lower of cost and net realisable value (NRV) (principle).

The NRV of the inventory is **$125,000** ($1 million/8). The closing exchange rate of 8 is used because NRV is a **monetary** measure.

Therefore the closing inventory will be $125,000 and a loss of $15,000 ($140,000 – $125,000) will be recognised in the statement of profit or loss for the year ended 30 September 20X5.

اتمنى لكم التوفيق و النجاح

و نرجو منكم الدعاء لى و لأهلى بالستر والصحة والعافية وراحة البال

شكراً لكم ،،،