ACCA

Paper P2 INT & UK

Corporate Reporting
September 2017

Revision Mock A – Answers

To gain maximum benefit, do not refer to these answers until you have completed the revision mock questions and submitted them for marking.

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1 BETH (INT SYLLABUS)

Key answer tips

Part (a) of this question involves the preparation of a consolidated statement of financial position. Control over the subsidiary has been achieved in stages. This means that a gain arises in profit or loss on the remeasurement of the previous shareholding to fair value. The goodwill calculation must also include both the consideration for the new shares and the fair value of the existing shares. Easy marks are always available in consolidated statement of financial position questions as long as you have learned the five standard workings off by heart.

Question 1 (c) tests ethics. Make sure that you leave sufficient time to write a good quality answer to this requirement as, once again, easy marks are available.

(a) Consolidated statement of financial position at 30 November 20X7

	$m	**Marks**
Assets		
Non-current assets		
Property, plant and equipment	1,925	3
(1,700 + 200 + 15 (W2) + 12 (W11) – 2 (W11))		
Intangible assets	300	
Goodwill (W3)	25	2 (W3)
Investment in associate (W7)	183	4 (W7)
	2,433	
Current assets		
Inventories (800 + 100)	900	
Trade receivables (600 + 60 – 1 (W8))	659	1
Cash and cash equivalents (500 + 40)	540	
	2,099	
Total assets	4,532	
Equity capital of $1	1,500	1
Other components of equity (W5)	319	2 (W5)
Retained earnings (W5)	457	7 (W5)
Non-controlling interest (W4)	54	3 (W4)
Total equity of the group	2,330	
Non-current liabilities (700 + 11 (W10) + 2 (W11))	713	2
Current liabilities (1,380 + 100 + 9 (W9))	1,489	1
Total equity and liabilities	4,532	26

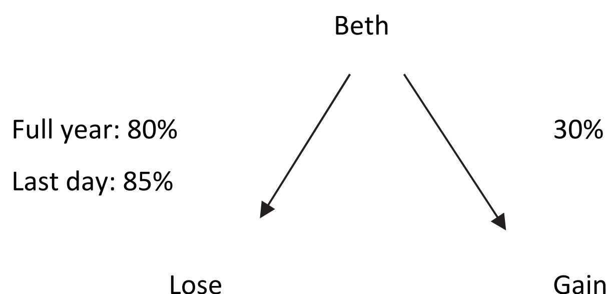
Other marks

PPE adjustments in (W2)	2
Control-to-control calculation (W6)	1
PURP calculation (W7)	1
Forex calculation (W8)	2
SARs calculation (W9)	1
Correct provision amount (W10)	1
Depreciation calculation (W11)	1
	35

Note: No marks are awarded for simply adding together the parent and the subsidiary. One mark is instead awarded for each adjustment (own figure rule applies). Marks for correct calculations are noted within the relevant workings.

Workings

(W1) Group structure



Where the acquirer already has an investment in the company and a further investment means that control is acquired then this is a step acquisition. The previously held investment is remeasured to fair value and the change in value reported in profit or loss.

The original investment in Lose of $40m now has a fair value of $70m, giving rise to a profit of $30m in profit or loss (W5).

Once control is achieved, the purchase of the additional 5% holding in Lose is accounted for in equity (W6).

Gain is an associate. It is accounted for using the equity method (W7).

(W2) Net assets of Lose

	At acq'n	*At rep date*	**Marks**
	$m	$m	
Ordinary shares	100	100	
Other components of equity	Nil	20	
Retained earnings	150	180	
Fair value adj (bal. fig.)	15	15	
Total	265	315	
Corrections			
Reversal of PPE write off (W11)		10	1
Additional depreciation on PPE (W11)		(2)	1
	265	323	2 max

(W3) Goodwill

	$m	**Marks**
Consideration for new shares	160	
Fair value of previous equity	70	1
Fair value of NCI at acquisition	60	1
	290	
Less FV of NA at acquisition (W2)	(265)	1
Goodwill at aqn/reporting date	25	2 max

(W4) Non-controlling interest

	$m	**Marks**
FV of NCI at acquisition	60	1
NCI % of post-acq net assets 20% × (323 – 265) (W2)	12	1
Control-to-control (W6)	(18)	1
	54	3 max

(W5) Group reserves

Group retained earnings

	$m	**Marks**
Beth	415	–
Lose: 80% × ((323 – 265) – (20 – nil))	30	1
Gain: 30% × (300 – 260)	12	1
Gain on revaluation of initial investment in Lose (70 – 40)	30	1
Impairment loss on associate (W7)	(6)	1
Associate PURP (W7)	(3)	1
Exchange loss on monetary item (W8)	(1)	1
SARs (W9)	(9)	1
Provision (W10)	(11)	1
	457	7 max

Group other components of equity

	$m	**Marks**
Beth	300	–
Lose: 80% × (20 – nil)	16	1
Control-to-control (W6)	3	1
	319	2 max

(W6) Control-to-control

	$m	**Marks**
Cash paid	15	
Decrease in NCI 5/20 × (60 + 12 (W4))	(18)	1
Increase in OCE	3	1 max

(W7) Associate

IAS 28 *Investments in Associates and Joint Ventures* requires profits and losses resulting from transactions between the investor and an associate to be recognised in the investor's financial statements only to the extent of the unrelated investor's interests in the associate. Effectively part of Beth's profit on the sale is eliminated to the extent of the company's shareholding in Gain.

	$m
Inventory: selling price	28
Cost	(18)
Profit	10

The profit to be eliminated is $3 million ($10 million × 30%). **(1 mark)**

Dr Profit or loss/retained earnings $3 million

Cr Investment in associate $3 million

The carrying amount of the associate, and the impairment loss on the investment, is calculated as follows:

	$m	**Marks**
Cost of investment	180	1
Share of retained earnings since acquisition: 30% × (300 – 260)	12	1
	192	
Less PURP (above)	(3)	1
Carrying amount	189	
Recoverable amount	(183)	1
Impairment loss	6	4 max

(W8) Deposit paid

The refundable deposit is a monetary amount which should be retranslated at the year end.

The deposit paid was $8 million ((50% × 12 million euros) ÷ 0.75). **(1 mark)**

At 30 November 20X7, the deposit would be retranslated to $7 million (6 million euros ÷ 0.85). Therefore, there will be an exchange loss of $1 million ($8m – $7m). **(1 mark)**

Dr Retained earnings $1 million

Cr Trade receivables $1 million

(W9) Share appreciation rights

In accordance with IFRS 2 *Share-based Payment,* the expense is based on the number of rights expected to vest, the fair value of the rights at the reporting date, and the proportion of the vesting period that has passed.

200 SARs × (10,000 – 600 – 500) × $10 × 1/2 = $8.9 million **(1 mark)**

Dr Retained earnings $9 million (rounded)

Cr Liabilities $9 million

(W10) Environmental provision

In this case, a provision should be made to include the costs of contamination in the countries where the law is to be enacted or has been enacted as there will be a legal obligation in those countries. Moral obligations to rectify environmental damage do not justify making a provision.

Therefore, a provision of $11 million (7 + 4) should be made. **(1 mark)**

Dr Retained earnings $11 million

Cr Non-current liabilities $11 million

(W11) PPE

Lose should capitalise the purchase price of $10 million and depreciate over the UEL in accordance with IAS 16 *Property, Plant and Equipment*. A provision of $2 million should be made for the dismantling and disposal of the asset.

Corrections need to be made in Lose's financial statements. The profit or loss impact needs to be adjusted against Lose's retained earnings (in W2). The following entries should be made:

Dr Property, plant and equipment $10m
Cr Profit or loss (W2) $10m
Dr Property, plant and equipment $2m
Cr Provision for decommissioning $2m

Depreciation is charged in full on property, plant and equipment in the year of acquisition.

The depreciation charge is $2 million (($10m + $2m) ÷ 6 years) **(1 mark)**

Dr Profit or loss (W2) $2m
Cr Property, plant and equipment $2m

(b) The direct and indirect methods are different ways of deriving and disclosing cash generated from operations in the statement of cash flows. **(1 mark)**

Under the indirect method, cash generated from operations is derived by adjusting profit before tax for the effects of non-cash items and items which are of an investing or financing nature. **(2 marks – 1 mark if reference is only made to non-cash items)**

Under the direct method, cash generated from operations is disclosed by showing major classes of gross cash receipts and gross cash payments. **(1 mark)**

For example, under the direct method, the entity will disclose 'cash receipts from customers', 'cash paid to suppliers' and 'cash paid to employees'. **(1 mark)**

Both methods, if faithfully represented, will derive the same figure for cash generated from operations. **(1 mark)**

However, IAS 7 *Statement of Cash Flows* encourages entities to report cash generated from operations using the direct method. **(1 mark)**

This is because the direct method provides information that might be useful in estimating future cash flows. **(1 mark)**

The categories disclosed under the direct method are likely to be more easily understood by the users of the financial statements than those disclosed in the indirect method. **(1 mark)**

The users of the financial statements can make more meaningful comparisons between cash flows presented using the direct method year-on-year. **(1 mark)**

It is also easier to compare two separate companies if they have both used the direct method in preparing their statement of cash flows. **(1 mark)**

Many users will not understand the indirect method and the complex adjustments which are made. **(1 mark)**

The adjustments made to profit in the indirect method may make it easier for the preparers of the statement of cash flow to allow bias to affect whether cash flows are reported within operating activities or elsewhere. **(1 mark)**

(Part b: 9 marks max)

(c) Beth and Banger are related parties because the companies are under common control. **(1 mark)**

The relationship between Beth and Banger must be disclosed in the financial statements, as well as any transactions and outstanding balances. **(1 mark)**

Beth would not be allowed to disclose that the transactions are at terms equivalent to those in an arm’s length transaction. **(1 mark)**

(IAS 24 knowledge and application: 2 marks max)

Financial statements are important to a range of user groups, such as shareholders, banks, employees and suppliers. These groups rely on the directors to faithfully represent the performance and position of the company. **(1 mark)**

A faithful representation is often presumed to have been provided if accounting standards have been complied with. Therefore, it is essential that the directors adhere to the requirements of IAS 24 *Related Party Disclosures*. **(1 mark)**

The transactions between Beth and Banger will distort the performance and position of both companies and may therefore affect the decisions made by users of the financial statements. **(1 mark)**

The finance director should follow the principles outlined in the ACCA Code of Ethics and Conduct. This sets out the importance of the fundamental principles of confidentiality, objectivity, professional behaviour, integrity, and professional competence and due care. **(1 mark)**

Integrity is defined as being honest and straight-forward. Attempting to disguise related party transactions shows a lack of integrity. **(1 mark)**

If such a decision has been motivated by a desire to disguise Beth’s true underlying performance from banks or shareholders, then this demonstrates a lack of objectivity. **(1 mark)**

If the director is unaware of the requirements of IAS 24, then s/he may lack professional competence. **(1 mark)**

(Discussion of ethical issues: 4 marks max)

(Part c: 6 marks max)

Marking scheme		
		Marks
(a)	Statement of financial position	35
(b)	Cash flows	9
(c)	Discussion of ethical responsibilities	6
Total		**50**

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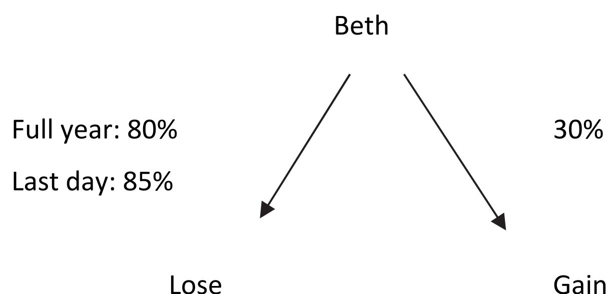

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(W6) Control-to-control

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Cr Liabilities \$9 million

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Dr Retained earnings $11 million

Cr Non-current liabilities $11 million

(W11) PPE

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Cr Profit or loss (W2) $10m
Dr Property, plant and equipment $2m
Cr Provision for decommissioning $2m

Depreciation is charged in full on property, plant and equipment in the year of acquisition.

The depreciation charge is $2 million (($10m + $2m) ÷ 6 years) **(1 mark)**

Dr Profit or loss (W2) $2m
Cr Property, plant and equipment $2m

(b) Goodwill

Under the IFRS for SMEs Standard, any negative goodwill arising on a business combination is immediately recognised in profit or loss. **(1 mark)**

Under FRS 102, negative goodwill is recognised immediately below goodwill on the statement of financial position. **(1 mark)**

The subsequent treatment of negative goodwill under FRS 102 is as follows:

– Any amount up to the fair value of the non-monetary assets acquired is recognised in profit or loss as the non-monetary assets are recovered. **(1 mark)**

– Any amount in excess of the fair value of the non-monetary assets acquired is recognised in profit or loss in the periods expected to be benefitted. **(1 mark)**

Defined benefit pension plans

FRS 102 states that the projected unit credit method must be used to estimate the size of the defined benefit obligation. **(1 mark)**

The IFRS for SMEs also requires entities to use the projected unit credit method, unless it involves undue cost or effort. **(1 mark)**

If so, the IFRS for SMEs Standard permits simplified ways of estimating a defined benefit obligation. **(1 mark)**

These simplifications include:

– Ignoring future estimated salary increases **(1 mark)**

– Ignoring future service of current employees **(1 mark)**

– Ignoring possible in-service mortality of current employees. **(1 mark)**

(Part b: 9 marks max)

(c) Beth and Banger are related parties because the companies are under common control. **(1 mark)**

All transactions between Beth and Banger must be disclosed in the financial statements, as well as any outstanding balances. **(1 mark)**

Beth would not be allowed to disclose that the transactions are at a rate equivalent to those in an arm's length transaction. **(1 mark)**

(IAS 24 knowledge and application: 2 marks max)

Financial statements are important to a range of user groups, such as shareholders, banks, employees and suppliers. These groups rely on the directors to faithfully represent the performance and position of the company. **(1 mark)**

A faithful representation is often presumed to have been provided if accounting standards have been complied with. Therefore, it is essential that the directors adhere to the requirements of IAS 24 *Related Party Disclosures* **(1 mark)**

The transactions between Beth and Banger will distort the performance and position of both companies and may therefore affect the decisions made by users of the financial statements. **(1 mark)**

The finance director should follow the principles outlined in the ACCA Code of Ethics and Conduct. This sets out the importance of the fundamental principles of confidentiality, objectivity, professional behaviour, integrity, and professional competence and due care. **(1 mark)**

Integrity is defined as being honest and straight-forward. Attempting to disguise related party transactions shows a lack of integrity. **(1 mark)**

If such a decision has been motivated by a desire to meet profit targets or to satisfy banks or shareholders, then this demonstrates a lack of objectivity. **(1 mark)**

If the director is unaware of the requirements of IAS 24, then s/he may lack professional competence. **(1 mark)**

(Discussion of ethical issues: 4 marks max)

(Part c: 6 marks max)

Marking scheme

		Marks
(a)	Statement of financial position	35
(b)	IFRS for SMEs Standard and FRS 102	9
(c)	Discussion of ethical responsibilities	6
Total		**50**

2 INNOVATE

Key answer tips

This is a scenario-based question based upon an entity in the process of completing its financial statements, subject to some matters outstanding. Often, there are multiple requirements, which may or may not be split into separate requirements and may also have a separate allocation of marks. Use the mark allocation to help with time–management to ensure that you attempt all parts of the question. Breadth and depth of knowledge across the syllabus is important to score well in these questions because several reporting standards may be relevant.

Section B answers are mainly discursive and explanatory, although some supporting computations may be necessary.

(a) IFRS 16 *Leases* says that a contract contains a lease if it '**conveys the right to control the use of an identified asset for a period of time in exchange for consideration**' (IFRS 16, para 9). **(1 mark)**

When deciding if a contract involves the right to control an asset, the customer must assess whether they have:

- The right to substantially all of the identified asset's economic benefits, and
- The right to direct the asset's use. **(2 marks)**

(IFRS 16 knowledge: 2 marks max)

The server is an identified asset because it is specified in the contract. **(1 marks)**

The supplier cannot substitute the asset unless it malfunctions so Innovate has the right to use the identified asset over the contract term. **(1 mark)**

Innovate has the right to direct the asset's use because it makes key decisions about how the server is used, such as the types of data stored on it. **(1 mark)**

Innovate is transferring consideration for use of the asset because it is making annual payments. **(1 mark)**

The contract is therefore a lease. **(1 mark)**

Innovate should recognise a lease liability for the present value of the payments to be made. The discount rate should be the rate implicit in the lease. **(1 mark)**

A right-of-use asset should be recognised at the same value as the liability, plus the direct costs (as well as any obligations to dismantle the asset). **(1 mark)**

(IFRS 16 application: 4 marks max)

(Part a: 6 marks max)

(b) To hedge account, the hedge must meet the effectiveness requirements in IFRS 9 *Financial Instruments*. **(1 mark)**

This would appear to be the case. The fair value movements in the hedged item and instrument are similar suggesting that they are related economically and that the hedged ratio is appropriate. **(1 mark)**

Under a cash flow hedge, the portion of the gain or loss on the instrument that is deemed to be an effective hedge is recognised in other comprehensive income. **(1 mark)**

Any remaining gain or loss on the instrument is recorded in profit or loss. **(1 mark)**

The derivative will be recognised as a financial asset with a fair value of $0.6 million. **(1 mark)**

A gain of $0.5 million will be recorded in other comprehensive income. **(1 mark)**

A gain of $0.1 million will be recorded in profit or loss **(1 mark)**

The hedged item – the future cash flow – is not recognised. **(1 mark)**

(IFRS 9 hedge accounting knowledge and application: 5 marks max)

(Part b: 5 marks max)

(c) IFRS 15 *Revenue from Contracts with Customers* says that the transaction price is the consideration that an entity expects to be entitled to in exchange for transferring goods or services to a customer. **(1 mark)**

Consideration paid to a customer is dealt with by reducing the transaction price as long as it is not in exchange for a distinct good or service. **(1 mark)**

Variable consideration is included in the transaction price if it is highly probable that a significant reversal in the amount of revenue recognised will not occur when the uncertainty is resolved. **(1 mark)**

If not recognised over time, revenue should be recognised at the point in time at which control passes to the customer. **(1 mark)**

(IFRS 15 knowledge: 2 marks max)

The $0.2 million paid to the supermarket reduces the transaction price to $2.8 million ($3m – $0.2m). **(1 mark)**

The variable consideration of $0.3 million cannot be included in the transaction price. **(1 mark)**

This is because Innovate does not have enough experience of this type of contract for it to be highly probable that a significant reversal in revenue will not occur. **(1 mark)**

Control over the computer games is likely to pass to the supermarket upon delivery. **(1 mark)**

This is because the supermarket will have physical possession and will assume the asset's key risks and rewards. **(1 mark)**

The revenue that should be recognised by the end of the year is $0.47m ($2.8m × 50,000/300,000). **(1 mark)**

(IFRS 15 application: 4 marks max)

(Part c: 6 marks max)

(d) IFRS 3 *Business Combinations* requires that the identifiable net assets of a subsidiary at the acquisition date are recognised at fair value. **(1 mark)**

IAS 12 *Income Taxes* requires entities to calculate deferred tax on temporary differences between the tax base of an asset or liability and its carrying amount. **(1 mark)**

No deferred tax arises on the initial recognition of goodwill itself, because IAS 12 specifically prohibits this. **(1 mark)**

(IFRS 3 and IAS 12 knowledge: 2 marks max)

Uplifting Ginger's inventory to fair value will give rise to a temporary difference because the carrying amount of inventories in the consolidated statements exceeds its tax base by \$1.6m. **(1 mark)**

This will give rise to a deferred tax liability in the consolidated financial statements for \$0.4m (\$1.6m × 25%). **(1 mark)**

This is recognised as a liability of the acquiree at the acquisition date. **(1 mark)**

Goodwill at acquisition is calculated as follows:

		\$m
Consideration		12.0
NCI at acquisition		2.0
Less FV of net assets:		
Share capital	1.0	
Retained earnings	5.0	
FV uplift	1.6	
Deferred tax on FV uplift	(0.4)	
		(7.2)
Goodwill at acquisition		6.8

(2 marks)

(IAS 12 application: 4 marks max)

(Part d: 6 marks max)

Marking scheme		
		Marks
(a)	Lease	6
(b)	Cash flow hedging	5
(c)	Revenue	6
(d)	Deferred tax	6
	Professional marks	2
Total		**25**

3 MUSIC

Key answer tips

This question covers standards which have proved popular in the P2 exam. A thorough understanding of these topics is therefore essential.

Many students are surprised by the lack of numbers in Section B. In order to score highly in these questions, you must demonstrate your knowledge of the relevant accounting standards **and** then attempt to apply this to the scenario. If you reach the wrong conclusion, you will still score marks for making relevant comments about the accounting standards.

(a) According to IFRS 15 *Revenue from Contracts with Customers,* the selling entity would recognise revenue over time if it cannot use the asset 'for an alternative use' and the entity can demand payment for its performance to-date. **(1 mark)**

When revenue is recognised over time, the amount recognised is based on the progress towards the satisfaction of the performance obligation. **(1 mark)**

When determining the transaction price, non-cash consideration is measured at its fair value. **(1 marks)**

(IFRS 15 knowledge: 2 marks max)

Revenue should be recognised over time because the asset created by Music has no alternative use and they also have an enforceable right to payment for the work completed to date. **(1 mark)**

The length of time between performance and payment is less than a year so there is not a significant financing component to the transaction. **(1 mark)**

The fair value of the consideration received and receivable is $3.2 million ($1.2m + $2m). **(1 mark)**

Revenue of $2.24 million ($3.2m × 70%) should therefore be recognised in the statement of profit or loss. **(1 mark)**

Music should recognise the equipment received at its fair value of $1.2 million and then depreciate it over its useful economic life of three years. **(1 mark)**

The depreciation charge in the current year will be $0.1 million (($1.2m/3) × 3/12) and the asset will have a carrying amount of $1.1 million ($1.2m – $1.1m). **(1 mark)**

Music should recognise an additional asset on the statement of financial position of $1.04 million ($2.24m – $1.2m). **(1 mark)**

This asset would be classified as a 'contract asset' rather than a 'receivable' because Music needs to complete its performance (or the customer needs to cancel the contract) before it is entitled to any payment. **(1 mark)**

(Application of IFRS 15 and IAS 16: 4 marks max)

(Part a: 6 marks)

(b) According to IFRS 9 *Financial Instruments*, a loss allowance should be recognised on financial assets that are debt instruments and which are measured at amortised cost or fair value through other comprehensive income. **(1 mark)**

If the credit risk of a financial asset has not increased significantly since inception, a loss allowance is recognised at an amount equal to 12-month expected credit losses. **(1 mark)**

If the credit risk of a financial asset has increased significantly since inception, a loss allowance is recognised at an amount equal to lifetime expected credit losses. **(1 mark)**

(IFRS 9 knowledge: 2 marks max)

Credit risk was low at inception. It can be concluded that credit risk has increased significantly if, at the reporting date, the credit risk of the asset is no longer low. **(1 mark)**

It would seem that credit risk has increased significantly since inception. **(1 mark)**

This is because of the following:

- The financial performance and cash generation of Jags have been poor and this will have impaired its ability to service its financing obligations
- The entity was close to breaching loan covenants at year end. A breach of covenants would potentially make loans repayable, thus having a detrimental impact on cash flow
- The decreased bond price appears to be entity specific and is therefore likely to reflect market concerns about Jags and its credit risk
- External agencies are reviewing the credit rating of Jags, suggesting that credit risk has increased since the publication of its latest financial results.

(1 mark each)

Due to the increase in credit risk, the loss allowance should be calculated at an amount equal to lifetime expected credit losses. **(1 mark)**

Increases/decreases in the allowance will be charged to profit or loss. **(1 mark)**

(IFRS 9 application: 4 marks max)

(Part b: 6 marks max)

(c) IFRS 9 *Financial Instruments* says that an entity has transferred a financial asset if it has transferred the contractual rights to receive the cash flows of the asset. **(1 mark)**

If an entity has transferred an asset, it must evaluate the extent to which it has retained the significant risks and rewards of ownership. **(1 mark)**

If the entity transfers substantially all the risks and rewards of ownership of the financial asset, the entity must derecognise the financial asset. **(1 mark)**

(IFRS 9 knowledge: 2 marks max)

The shares have been legally transferred to Noise, who is entitled to any dividends arising from the investment. **(1 mark)**

Music does not benefit from future share price increases meaning that this key reward of ownership has been transferred to Noise. **(1 mark)**

Music is under no obligation to buy back the shares and is therefore protected from deterioration in the performance or desirability of the shares. **(1 mark)**

If Music does repurchase the shares, this will be at fair value rather than a pre-fixed price and therefore they do not retain the risks and rewards related to price fluctuations. **(1 mark)**

The risks and rewards of ownership have been transferred to Noise. This means that the asset should be de-recognised and a profit or loss on disposal recorded in the statement of profit or loss. **(1 mark)**

Any gains or losses previously recognised in other comprehensive income are not reclassified to profit or loss. However, they may be transferred in equity (from 'other components of equity' to 'retained earnings'). **(1 marks)**

You may have concluded that Music should not derecognise the investment. Your answer will still score 1 mark per point, as long as your argument is clear and applies IFRS 9 to the scenario.

(Application of IFRS 9: 3 marks max)

(Part c: 5 marks)

(d) According to IFRS 10 *Consolidated Financial Statements*, an investor controls an investee if the investor has:

- power over the investee
- exposure to variable returns from the investee
- the ability to affect the amount of its returns from the investee. **(1 mark)**

According to IFRS 11 *Joint Arrangements*, joint control is where the relevant activities require unanimous consent of those who collectively control the arrangement. **(1 mark)**

A joint operation is an arrangement whereby the parties that have joint control have rights to the assets, and obligations relating to the liabilities, of the arrangement. **(1 mark)**

A joint venture is an arrangement whereby the parties that have joint control have rights to the net assets of the arrangement. This usually involves the establishment of a separate entity. **(1 mark)**

(IFRS 10/11 knowledge: 2 marks max)

Music does not control Rhythm, because it lacks the ability to exercise power over the investee. This is because Music needs the agreement of Lullaby when making decisions and therefore does not have the current ability to direct Rhythm's relevant activities. **(1 mark)**

Rhythm is not a subsidiary of Music. It is also not an associate. **(1 mark)**

Music and Lullaby would seem to have joint control over Rhythm because decisions about its activities cannot be made without both Music and Lullaby agreeing. **(1 mark)**

The fact that Rhythm is liable for its own debts suggests that the venturers have rights to the net assets of the arrangement, rather than having an obligation for the liabilities of the arrangement. **(1 mark)**

As such, Rhythm should be classified as a joint venture. **(1 mark)**

In the consolidated financial statements, Music will account for Rhythm using the equity method. **(1 mark)**

(IFRS 10/11 application: 4 marks max)

(Part d: 6 marks)

Marking scheme		
		Marks
(a)	Revenue	6
(b)	Financial asset impairment	6
(c)	Derecognition of financial instruments	5
(d)	Joint arrangements	6
	Professional marks	2
Total		**25**

4 FRAMEWORK

Key answer tips

Question 4 is always an essay-style question requirement, which can include a small computation element. It may focus upon current issues in financial reporting, or upon a theoretical or conceptual issue.

If the focus is upon current issues, you should be prepared to explain the current financial reporting treatment based upon existing reporting standards, weaknesses in the required accounting treatment, and how any proposed replacement reporting standard will improve the situation.

(a) The Conceptual Framework (Framework) provides the fundamental basis for the development of International Financial Reporting Standards. **(1 mark)**

As such it is important that the Framework is robust and kept up to date with changes in financial reporting. **(1 mark)**

Some aspects of the current Framework are considered to be out of date. For example, IFRS Standards increasingly require items to be measured at fair value and yet this measurement base is not mentioned in the Framework. **(1 mark)**

Some areas of the Framework are not consistently applied across the full range of IFRS and IAS Standards. An example of this is the definitions of 'assets' and 'liabilities', which the Board are proposing to update. **(1 mark)**

Some important areas are not covered in the current Framework. For example, principles surrounding derecognition are not addressed. **(1 mark)**

The Board also wishes to reintroduce references to the role of 'prudence' and 'substance over form'. **(1 mark)**

The Framework provides little guidance on the measurement of transactions.
(1 mark)

The Framework provides little guidance on presentation and disclosure.
(1 mark)

Some areas of the Framework are unclear. For example, the distinction between profit and other comprehensive income (OCI) is not clear, nor are the reasons why some items are reclassified from OCI to profit. **(1 mark)**

Extent to which entities will be affected

The Framework is not an accounting standard itself and does not over-ride the requirements in individual IFRS or IAS Standards. **(1 mark)**

Hence the proposals will not immediately affect entities in preparing their financial statements. **(1 mark)**

Some entities refer to the Framework to develop an appropriate policy if no specific policy or guidance exists. These entities are therefore more likely to be affected directly. **(1 mark)**

The Board will use revisions to the Framework when developing future accounting standards and so entities will be affected when they implement the standards that are based on the revised Framework. **(1 mark)**

However, the Board have stated that they will not alter existing standards that work well in practice simply because they are inconsistent with the revised Framework.
(1 mark)

Auditors may use the Framework when deciding the appropriateness of particular accounting treatments. A revised Framework may lead to alternative conclusions.
(1 mark)

(Part a: 11 marks max)

(b) **Share-based payment**

The Framework defines an expense as a decrease in economic benefits that result in decreases in equity (other than those related to distributions to equity participants).
(1 mark)

In the case of a cash-settled share-based payment, the entity has an obligation to pay cash in the future. This therefore meets the definition of an expense. **(1 mark)**

However, in the case of an equity-settled share-based payment, the entity is providing equity as payment for the good/service. There is therefore no reduction in an asset or increase in a liability in accordance with the definition of an expense.
(1 mark)

Indeed an equity-settled share-based payment has no net impact on equity (expenses reduce retained earnings, but the other side of the transaction increases other components of equity). **(1 mark)**

Although IFRS 2 *Share Based Payment* requires the recognition of an expense for equity-settled schemes, it can be argued that this is not in accordance with the definitions in the Framework. **(1 mark)**

(Max: 4 marks)

Non-refundable deposits

The Framework defines a liability as a present obligation from a past event which is expected to result in an outflow of economic benefits to settle the obligation.**(1 mark)**

In this example, there is no obligation to repay the cash because the deposit is non-refundable. **(1 mark)**

Consequently it is sometimes believed that the deposit amount should not be recognised as a liability but instead as income. **(1 mark)**

This is because income is defined as an increase in economic benefits that results in increases in equity (other than those relating to equity participants). **(1 mark)**

Nonetheless, there is an obligation to transfer the related goods or services to the customer – and these represent economic benefits – thus appearing to meet the definition of a liability. **(1 mark)**

However, it can be argued that this obligation to transfer goods/services should be recognised at the cost to the entity of providing the goods/services rather than the price that was charged to the customer. **(1 mark)**

(Max: 4 marks)

Internally generated brands

The Framework defines an asset as a resource controlled by an entity as a result of a past event that will lead to a probable inflow of economic benefits. **(1 mark)**

Brands, whether internally generated or purchased, do therefore meet the definition of an asset. **(1 mark)**

The Framework says that items are recognised in the financial statements if they meet the definition of an element, and if the cost or value can be measured reliably. **(1 mark)**

The cost of an internally generated brand cannot be measured reliably. **(1 mark)**

This is because the costs of developing a brand cannot be separated from the day-to-day running costs of the business. **(1 mark)**

Therefore, the fact that internally generated brands are not recognised in the financial statements is consistent with the Framework. **(1 mark)**

(Max: 4 marks)

(Part b max: 12 marks)

Marking scheme		
		Marks
(a)	Framework revisions	11
(b)	Transactions and the Framework	12
	Professional marks	2
Total		**25**

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