Answers

1 (a) Bubble Group: Statement of financial position as at 31 October 2015

	$m
Assets	
Non-current assets	
Goodwill (W3)	26·1
Property, plant and equipment (W7)	434·5
Financial assets (W8)	26·3
	486·9
Current assets	
Inventories (W9)	33·7
Trade and other receivables (W10)	58·8
Cash and cash equivalents (W11)	34·5
	127
Total assets	613·9
Equity and liabilities	
Equity shares	80
Retained earnings (W13)	246·8
Translation reserve (W4)	(7)
Other components of equity (W12)	41·4
Total shareholder's equity	361·2
Non-controlling interest (W14)	52·4
Total equity	413·6
Non-current liabilities (W15)	111·4
Current liabilities (W16)	88·9
Total equity and liabilities	613·9

Working 1: Salt

Net assets at acquisition will be as follows:

	$m
Share capital	50
Retained earnings	56
Other components of equity	8
Fair value adjustment re non-depreciable land	6
Fair value of net assets	120
Contingent liability at fair value	(1)
Fair value of net assets at acquisition	119

Goodwill of Salt:

Fair value of consideration for 80% interest	110
Fair value of non-controlling interest at acquisition	25
	135
Fair value of net assets at acquisition	(119)
Goodwill	16

Working 2: Intra-group loan

The loan is a foreign currency monetary item in Tyslar's financial statements which means it needs to be retranslated at the closing rate of exchange. The exchange differences should have been recorded through Tyslar's profit or loss and will therefore affect retained earnings.

	$m	Exchange rate	Dinars m
1 February 2015	10	9 Dinars:$1	90
Cash paid 1 July 2015	(5)	10 Dinars:$1	(50)
			40
Exchange rate loss – balancing figure 31 October 2015			7·5
	5	9·5 Dinars:$1	47·5

To correct, increase Tyslar's non-current liabilities by 7·5 million dinars and reduce retained earnings by a corresponding amount. In addition, after retranslation, $5m will be cancelled from both financial assets and non-current liabilities as an intra-group adjustment.

Working 3: Translation and goodwill of Tyslar

	Dinars m	Dinars m Loan adj	Rate	$m
Property, plant and equipment	390		9·5	41·1
Financial assets	98		9·5	10·3
Inventories	16		9·5	1·7
Trade and other receivables	36		9·5	3·8
Cash and cash equivalents	90		9·5	9·5
				66·4
Share capital	210		8	26·3
Retained earnings – pre-acquisition	258		8	32·2
– post-acquisition	34	(7·5)	8·5	3·1
Exchange difference (balance)				(9·5)
Non-current liabilities	110	7·5	9·5	12·4
Current liabilities	18		9·5	1·9
				66·4

The exchange differences on Tyslar's profits and opening net assets may also be calculated as:

	$m
Opening net assets at the opening rate (210m + 258m) at 8	58·5
Profit for the year at the average rate (34m – 7·5m) at 8·5	3·1
Exchange difference (bal) (W4)	(9·5)
Closing net assets at the closing rate (210m + 292m – 7·5m) at 9·5	52·1

Goodwill of Tyslar:

	Dinars m	Ex rate	$m
Cost of acquisition	368	8	46
Non-controlling interest	220	8	27·5
Total	588		73·5
Less net assets acquired (210m + 258m)	(468)	8	(58·5)
	120		15
Impairment (120 x 20%)	(24)	8·5	(2·8)
			12·2
Exchange difference (bal)			(2·1)
	96	9·5	10·1

Since goodwill is under the fair value method, both the impairment and the exchange loss will be apportioned 60:40 between the shareholders of the parent and non-controlling interest respectively. Any goodwill arising on the acquisition of a foreign operation is treated as an asset of the foreign operation and retranslated at the closing rate.

In summary:

Goodwill for consolidated SFP will be ($16m (W1) + $10·1m) = $26·1m.

The impairment is $2·8m of which 60% ($1·7m) will be charged against group retained earnings and 40% ($1·1m) will be charged to the NCI.

Working 4: Summary of exchange differences

	Total $m	60% Translation reserve $m	40% NCI $m
Exchange loss on opening net assets and profits (W3)	9·5	5·7	3·8
Exchange loss on goodwill (W3)	2·1	1·3	0·8
	11·6	7	4·6

Working 5: Exchange of assets

The transaction has commercial substance and so the cost of the property acquired should be measured at the fair value of the asset given up. The fair value of the asset given up can be reliably measured using IFRS 13 principles and so the property should have been recorded at $7m rather than $5m. A profit on disposal should have arisen of $2m which will need to be credited to retained earnings. The $0·5m spent on staff relocation is not directly attributable to the property and so should have been expensed. Depreciation should be charged of $7m/35 x 6/12 = $100,000. This would leave a carrying amount before revaluation at 31 October 2015 of $6·9m. The fair value at this date is 75m dinars/9·5 = $7·9m. A revaluation gain should be recorded in other components of equity of $1m.

Working 6: Pension scheme

	$
Opening liability	15
Net interest cost ($15m x 8%)	1·2
Current service cost	5
Gain on curtailment ($4m – $3m)	(1)
Cash contributions into the scheme	(6)
	14·2
Loss on remeasurement	2·8
Closing liability	17

The cash contributions of $6m will need to be reversed from profit or loss and will reduce the net obligation on the pension scheme. The interest costs of $1·2m and current service cost of $5m must be expensed and the gain on curtailment of the pension scheme credited to profit or loss (and so to retained earnings). The remeasurement loss of $2·8m should be deducted from other comprehensive income (and so to other components of equity). The net effect on the pension scheme is an increase in the liability of $2m to $17m.

Working 7: Property, plant and equipment

	$m
Bubble	280
Salt	105
Tyslar (390m dinars/9·5)	41·1
Gain on disposal on exchange (W5)	2
Depreciation (W5)	(0·1)
Write off of relocation expenses (W5)	(0·5)
Revaluation gain (W5)	1
Fair value adjustment land – Salt (W1)	6
	434·5

Working 8: Financial assets

	$m
Bubble	12
Salt	9
Tyslar (98m dinars/9·5)	10·3
Intra-group loan (W2)	(5)
	26·3

Working 9: Inventories

	$m
Bubble	20
Salt	12
Tyslar (16m Dinars/9·5)	1·7
	33·7

Working 10: Trade and other receivables

	$m
Bubble	30
Salt	25
Tyslar (36m dinars/9·5)	3·8
	58·8

Working 11: Cash and cash equivalents

	$m
Bubble	14
Salt	11
Tyslar (90m Dinars/9·5)	9·5
	34·5

Working 12: Other components of equity

	$m
Bubble	40
Revaluation gain (W5)	1
Loss on remeasurement component (W6)	(2·8)
Share of post-acquisition of Salt (80% of ($12m – $8m))	3·2
	41·4

Working 13: Retained earnings

	$m
Bubble	230
Disposal gain on exchange of PPE (W5)	2
Removal staff relocation expenses (W5)	(0·5)
Depreciation of PPE (W5)	(0·1)
Cash contributions on pension (W6)	6
Service cost component ($5m + $1·2m) (W6)	(6·2)
Gain on curtailment (W6)	1
Impairment of goodwill of Tyslar (W3)	(1·7)
Share of post-acquisition profits of Salt (80% of ($74m – $56m))	14·4
Share of post-acquisition profits of Tyslar (W3) (60% of (26·5m dinars/8·5m))	1·9
	246·8

Working 14: Non-controlling interest

	$m
Fair value of NCI in Salt at acquisition	25
NCI share of post-acquisition retained earnings (20% of ($74m – $56m))	3·6
NCI share of post-acquisition OCE (20% of ($12m – $8m))	0·8
	29·4
Fair value of NCI in Tyslar at acquisition (220m dinars/8)	27·5
Impairment of goodwill of Tyslar (W3)	(1·1)
Exchange loss attributable to NCI (W4)	(4·6)
NCI share of post-acquisition profits (40% of (26·5m dinars/8·5))	1·2
	23
	52·4

Working 15: Non-current liabilities

	$m
Bubble	95
Salt	7
Tyslar ((110m + 7·5m) dinars/9·5)	12·4
Pension scheme	2
Intra group adjustment (W2)	(5)
	111·4

Working 16: Current liabilities

	$m
Bubble	67
Salt	19
Tyslar (18m Dinars/9·5)	1·9
Contingent liability (W1)	1
	88·9

(b) The section of the IFRS for SMEs on income tax has been replaced in its entirety by the section in FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland*. FRS 102 recognises deferred tax on the basis of timing differences, not temporary differences as does the IFRS for SMEs (and IAS 12 *Income Taxes*). However, the FRS 102 approach, while similar to the previous RoI GAAP, is not identical. It is known as the 'timing differences plus' approach.

Under FRS 102, deferred tax is recognised in respect of all timing differences at the reporting date, with some exceptions. Timing differences are differences between taxable profits and total comprehensive income as stated in the financial statements which arise from the inclusion of income and expenses in tax assessments in periods different from those in which they are recognised in financial statements. Deferred tax should be recognised in respect of all timing differences at the reporting date, subject to certain exceptions.

Unrelieved tax losses and other deferred tax assets are recognised only to the extent that it is probable that they will be recovered against the reversal of deferred tax liabilities or other future taxable profits. The very existence of unrelieved tax losses is strong evidence that there may not be other future taxable profits against which the losses will be relieved.

Under IFRS for SMEs, an entity recognises a deferred tax asset or liability for tax recoverable or payable in future periods as a result of past transactions or events. Such tax arises from the difference between the amounts recognised for the entity's assets and liabilities in the statement of financial position and the recognition of those assets and liabilities by the tax authorities plus the carry forward of currently unused tax losses and tax credits. A deferred tax asset must be recognised for all temporary differences which are expected to reduce taxable profit in the future. An entity must recognise a valuation allowance against deferred tax assets so that the net carrying amount equals the highest amount which is more likely than not to be recovered based upon current or future taxable profit. An entity must review the net carrying amount of a deferred tax asset at each reporting date and adjust the valuation allowance to reflect the current assessment of future profits. Such adjustment is recognised in profit or loss except if it is attributable to an item in other comprehensive income (OCI) in which case it is recognised in OCI.

(c) If Bubble were to sell the shares profitably, a gain would arise in its individual financial statements which would boost retained earnings. However, if only 5% of the equity shares in Tyslar were sold, it would still hold 55% of the equity and presumably control would not be lost. The International Accounting Standards Board views this as an equity transaction (i.e. transactions with owners in their capacity as owners). This means that the relevant proportion of the exchange differences should be re-attributed to the non-controlling interest rather than to the retained earnings. The directors appear to be motivated by their desire to maximise the balance on the group retained earnings. It would appear that the directors' actions are unethical by overstating the group's interest in Tyslar at the expense of the non-controlling interest.

The purpose of financial statements is to present a fair representation of the company's position and if the financial statements are deliberately falsified, then this could be deemed unethical. Accountants have a social and ethical responsibility to issue financial statements which do not mislead the public. Any manipulation of the accounts will harm the credibility of the profession since the public assume that professional accountants will act in an ethical capacity. The directors should be reminded that professional ethics are an integral part of the profession and that they must adhere to ethical guidelines such as the ACCA's *Code of Ethics and Conduct*. Deliberate falsification of the financial statements would contravene the guiding principles of integrity, objectivity and professional behaviour. The directors' intended action appears to be in direct conflict with the code by deliberating overstating the parent company's ownership interest in the group in order to maximise potential investment in Bubble.

Stakeholders are becoming increasingly reactive to the ethical stance of an entity. Deliberate falsification would potentially harm the reputation of Bubble and could lead to severe, long-term disadvantages in the market place. The directors' intended action will therefore not be in the best interests of the stakeholders in the business. There can be no justification for the deliberate falsification of an entity's financial statements.

2 (a) IAS 38 *Intangible Assets* requires an entity to recognise an intangible asset, whether purchased or self-created (at cost) if, and only if:

(i) It is probable that the future economic benefits which are attributable to the asset will flow to the entity; and
(ii) the cost of the asset can be measured reliably.

This requirement applies whether an intangible asset is acquired externally or generated internally. IAS 38 includes additional recognition criteria for internally generated intangible assets.

The probability of future economic benefits must be based on reasonable and supportable assumptions about conditions which will exist over the life of the asset. The probability recognition criterion is always considered to be satisfied for intangible

assets which are acquired separately or in a business combination. If an intangible item does not meet both the definition of and the criteria for recognition as an intangible asset, IAS 38 requires the expenditure on this item to be recognised as an expense when it is incurred. Research constitutes original and planned investigations undertaken with the prospect of gaining new scientific or technical knowledge and understanding. No intangible assets arising from research should be recognised. Expenditure on research should be recognised as an expense when it is incurred.

In this case, Chemclean should recognise an intangible asset for the use of Jomaster's technology. The right should be measured at its cost of $4 million. The intangible asset should be amortised from the date it is available for use. The technology is available for use when the manufacturing of the compound begins. The amortisation should be presented as cost of sales in the statement of profit or loss if expenses are presented by function or as amortisation if expenses are presented by nature, as it is an expense directly related to the production of the compound. At the end of each reporting period, Chemclean is required to assess whether there is any indication that the asset may be impaired, that is, its carrying amount may be higher than its recoverable amount.

The price an entity pays to acquire an intangible asset reflects expectations about the probability that the expected future economic benefits from the asset will flow to the entity. The effect of probability is therefore reflected in the cost of the asset.

Due to the nature of intangible assets, subsequent expenditure will only rarely meet the criteria for being recognised in the carrying amount of an asset. Thus Chemclean continues to expense its own internal development expenditure until the criteria for capitalisation are met and economic benefits are expected to flow to the entity from the capitalised asset. When the drug is sold, the royalty payments are presented in the statement of profit or loss.

IFRS 10 *Consolidated Financial Statements* defines control of an investee in terms of the following: 'An investor controls an investee when the investor is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee.' Therefore it appears that Chemclean will control Conew.

IFRS 3 *Business Combinations* defines a 'business' as 'an integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing a return in the form of dividends, lower costs or other economic benefits directly to investors or other owners, members or participants.' A business consists of inputs and processes applied to those inputs which have the ability to create outputs. Although businesses usually have outputs, outputs are not required for an integrated set to qualify as a business. Processes are defined in IFRS 3 as any system, standard, protocol, convention or rule which creates or has the ability to create output. Any transaction in which an entity obtains control of one or more businesses qualifies as a business combination and is subject to the measurement and recognition requirements of IFRS 3. Processes are included in the acquired group when intellectual property (IP) is accompanied by other resources such as assets or employees or other elements such as protocols and plans which will further help develop the IP to the next phase. The formation of a legal entity, which is involved in the transaction, is an irrelevance and the legal form of the transaction does not determine the accounting treatment. Here, the acquisition of an interest in Conew is an asset acquisition and should be accounted for under IAS 38 because Conew does not meet the definition of a business.

(b) IAS 1 *Presentation of Financial Statements* provides little specific guidance on the presentation of line items in financial statements, such as the level of detail or number of line items which should be presented in the financial statements. Furthermore, IAS 1's objective is to set out 'the overall requirements for the presentation of financial statements, guidelines for their structure and minimum requirements for their content'. In doing so, IAS 1 sets out minimum levels of required items in the financial statements by requiring certain items to be presented on the face of, or in the notes to, the financial statements and in other required disclosures. The current requirements in IFRS do not provide a definition of 'gross profit' or 'operating results' or many other common subtotals. The absence of specific requirements arises from the fact that the guidance in IAS 1 relies on management's judgement about which additional line items, headings and subtotals:

(a) are relevant to an understanding of the entity's financial position/financial performance; and
(b) should be presented in a manner which provides relevant, reliable comparable and understandable information.

IAS 1 allows entities to include additional line items, amend descriptions and the ordering of items in order to explain the elements of financial performance due to various activities, which may differ in frequency and predictability.

In the case of Chemclean, the cost of the inventories sold should be presented as cost of goods sold and not split in the manner set out by Chemclean. IFRS 3 *Business Combinations* requires an acquirer to measure the identifiable assets acquired in a business combination at their fair values at the date of acquisition. Therefore, the carrying amount of the inventories originating from the acquisition of the subsidiary is their acquisition date fair value.

IAS 2 *Inventories* requires the carrying amount of inventories sold to be recognised as an expense in the period in which the related revenue is recognised. Cost of sales are costs previously included in the measurement of inventory which has now been sold plus unallocated production overheads and abnormal amounts of production costs of inventories. Consequently, the entire carrying amount of inventory, including the effects of the fair value step-up, should be presented as cost of sales. Transactions like business combinations may have a significant impact on profit or loss and these transactions are not necessarily frequent or regular. However, the practice of presenting non-recurring items may be interpreted as a way to present 'extraordinary items' in the financial statements despite the fact that 'extraordinary items' are not allowed under IAS 1. It can also be argued that additional lines and subtotals, as permitted by IAS 1, may add complexity to the analysis of the financial statements, which may become difficult to understand if entities use sub-totals and additional headings to isolate the effects of non-recurring transactions from classes of expense or income.

(c) Chemclean should not have fully recognised the deferred tax asset arising from the carry forward of unused tax losses. It is recognisable only to the extent of its taxable temporary differences. IAS 12 *Income Taxes* states that a deferred tax asset shall

be recognised for the carry forward of unused tax losses to the extent that it is probable that future taxable profit will be available against which unused tax losses can be utilised. IAS 12 explains that the existence of unused tax losses is strong evidence that future taxable profit may not be available. Therefore, when an entity has a history of recent losses, the entity recognises a deferred tax asset arising from unused tax losses only to the extent that the entity has sufficient taxable temporary differences or when there is convincing other evidence that sufficient taxable profit will be available against which the unused tax losses can be utilised by the entity.

Chemclean recognised losses during the previous five years. In order to use the deferred tax asset of $16 million, Chemclean would have to recognise a profit of $53·3 million at the existing tax rate of 30%. In comparison, the entity recognised an average loss of $19 million per year during the five previous years. There should be convincing evidence showing that there would be taxable profits available in the future in order to recognise a deferred tax asset. A comparison of the budgeted results to its actual results for the previous two years indicated material differences relating to impairment losses. In the interim financial statements for the first half of the financial year to 30 June 2015, Chemclean recognised impairment losses equal to budgeted impairment losses for the whole year. The unused tax losses appear to result from identifiable causes, which are likely to recur. IAS 12 states that in assessing the probability that taxable profit will be available against which the unused tax losses or unused tax credits can be utilised, a consideration is whether the unused tax losses result from identifiable causes which are unlikely to recur.

Chemclean's budgets and assumptions are not convincing other evidence because the entity does not appear to have been capable of making accurate forecasts in the past and there were material differences between the amounts budgeted and realised for the previous two years. Chemclean had presented future budgets primarily based on general assumptions about the development of key products and economic improvement indicators, rather than what was expected to influence the future income and therefore enable the use of the deferred tax asset. Finally, in its financial statements, Chemclean disclosed a material uncertainty about its ability to continue as a going concern. This would be a key factor when considering the recognition of a deferred tax asset.

Therefore no deferred tax asset or liability should be recognised. The liability of $3 million relating to temporary differences can be offset against $3 million of unused tax losses. No further tax losses should be recognised.

3 (a) (i) The classification of a joint arrangement as a joint operation or a joint venture depends upon the rights and obligations of the parties to the arrangement (IFRS 11 *Joint Arrangements*). A joint arrangement occurs where two or more parties have joint control. The contractually agreed sharing of control of an arrangement exists only when decisions about the relevant activities require the unanimous consent of the parties sharing control. The structure and form of the arrangement determines the nature of the relationship. However, regardless of the purpose, structure or form of the arrangement, the classification of joint arrangements depends upon the parties' rights and obligations arising from the arrangement. A joint arrangement which is not structured through a separate vehicle is a joint operation. In such cases, the contractual arrangement establishes the parties' rights and obligations. A joint operator accounts for the assets, liabilities, revenues and expenses relating to its involvement in a joint operation in accordance with the relevant IFRSs. The arrangement with Gogas is a joint operation as there is no separate vehicle involved and they have agreed to share services and costs with decisions regarding the platform requiring unanimous agreement of the parties. Gasnature should recognise its share of the asset as property, plant and equipment.

Under IAS 16 *Property, Plant and Equipment* (PPE), the cost of an item of property, plant and equipment includes the initial estimate of the costs of dismantling and removing the item and restoring the site on which it is located. IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* contains requirements on how to measure decommissioning, restoration and similar liabilities. Where the effect of the time value of money is material, the amount of a provision should be the present value of the expenditures expected to be required to settle the obligation. Thus costs incurred by an entity in respect of obligations for dismantling, removing and restoring the site on which an item of property, plant and equipment is located are recognised and measured in accordance with IAS 16 and IAS 37. Thus Gasnature should recognise 55% of the cost of decommissioning the underground storage facility. However, because Gasnature is a joint operator, there is also a contingent liability for 45% of the decommissioning costs as there is a possible obligation for the remainder of the costs depending on whether some uncertain future event occurs, that is, Gogas goes into liquidation and cannot fund the decommissioning costs. Therefore Gasnature should also disclose a contingent liability relating to Gogas's share of the obligation to the extent that it is contingently liable for their share.

IAS 16 states that property, plant and equipment are tangible items which:

(a) are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes; and

(b) are expected to be used during more than one period.

Thus Gasnature should classify and account for its share of the irrecoverable gas as PPE. The irrecoverable gas is necessary for the storage facility to perform its function as a gas storage facility. It is therefore part of the storage facility and should be capitalised as a component of the storage facility asset. The irrecoverable gas should be depreciated to its residual value over the life of the storage facility. However, if the gas is recoverable in full when the storage facility is decommissioned, then depreciation will be recorded against the irrecoverable gas component only if the estimated residual value of the gas decreases below cost during the life of the facility. When the storage facility is decommissioned and the cushion gas extracted and sold, the sale of the irrecoverable gas is accounted for as the disposal of an item of

PPE in accordance with IAS 16 and the gain or loss recognised in profit or loss. The natural gas in excess of the irrecoverable gas which is injected into the facility should be treated as inventory in accordance with IAS 2 *Inventories*.

(ii) IFRS 9 *Financial Instruments* applies to those contracts to buy or sell a non-financial item which can be settled net in cash with the exception of contracts which are held for the purpose of the receipt or delivery of a non-financial item in accordance with the entity's expected purchase, sale or usage requirements (own use contract). In other words, it will result in physical delivery of the commodity. Contracts which are for an entity's 'own use' are exempt from the requirements of IFRS 9. Such a contract can be irrevocably designated as measured at fair value through profit or loss even if it was entered into for the above purpose. This designation is available only at inception of the contract and only if it eliminates or significantly reduces a recognition inconsistency (sometimes referred to as an 'accounting mismatch') which would otherwise arise from not recognising that contract because it is excluded from the scope of IFRS 9. There are various ways in which a contract to buy or sell a non-financial item can be settled net in cash or another financial instrument or by exchanging financial instruments. These include:

(a) when the terms of the contract permit either party to settle it net in cash;

(b) when the ability to settle net in cash is not explicit in the terms of the contract, but the entity has a practice of settling similar contracts net in cash;

(c) when, for similar contracts, the entity has a practice of taking delivery of the underlying and selling it within a short period after delivery for the purpose of generating a profit;

(d) when the non-financial item which is the subject of the contract is readily convertible to cash.

A written option to buy or sell a non-financial item which can be settled net in cash is within the scope of IFRS 9. Such a contract cannot be entered into for the purpose of the receipt or delivery of the non-financial item in accordance with the entity's expected purchase, sale or usage requirements. Contracts to buy or sell a non-financial item, such as a commodity, which can be settled net in cash or another financial instrument, or by exchanging financial instruments, are within the scope of IFRS 9. They are accounted for as derivatives. A level of judgement will be required in this area as net settlements caused by unique events beyond management's control may not necessarily prevent the entity from applying the 'own use' exemption to all similar contracts.

The contract entered into by Gasnature with Agas seems to be an own use contract which falls outside IFRS 9 and therefore would be treated as an executory contract. However, it could be argued that the contract is net settled because the penalty mechanism requires Agas to compensate Gasnature at the current prevailing market price. Further, if natural gas is readily convertible into cash in the location where the delivery takes place, the contract could be considered net settled. Additionally, if there is volume flexibility, then the contract could be regarded as a written option, which falls within the scope of IFRS 9.

However, the contract will probably still qualify as 'own use' as long as it has been entered into and continues to be held for the expected counterparties' sales/usage requirements. Additionally, the entity has not irrevocably designated the contract as measured at fair value through profit or loss, thus adding weight to the 'own use' designation.

(b) (i) It is not acceptable to accrue the costs of the overhaul. The entity does not have a constructive obligation to undertake the overhaul. Under IFRS for SMEs, costs related to major inspection and overhaul are recognised as part of the carrying amount of property, plant and equipment if they meet the asset recognition criteria. The major overhaul component will then be depreciated on a straight-line basis over its useful life (i.e. over the period to the next overhaul) and any remaining carrying amount will be derecognised when the next overhaul is performed. Costs of the day-to-day servicing of the asset (i.e. routine maintenance) are expensed as incurred. Therefore the cost of the overhaul should have been identified as a separate component of the machine at initial recognition and depreciated over a period of two years. This will result in the same amount of expense being recognised in the income statement over the same period as the proposal to create a provision.

(ii) Under the IFRS for SMEs, an entity must measure all items of property, plant and equipment after initial recognition at cost less any accumulated depreciation and any accumulated impairment losses. Under FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland*, an entity may measure all items of property, plant and equipment after initial recognition using the cost model or the revaluation model. Where the revaluation model is selected, this must be applied to all items of property, plant and equipment.

The IFRS for SMEs states that an entity should change an accounting policy only if the change results in the financial statements providing reliable and more relevant information about the effects of transactions and events on the entity's financial position, financial performance or cash flows.

It also states that when a change in accounting policy is applied retrospectively, the entity must apply the new accounting policy to comparative information for prior periods to the earliest date for which it is practicable, as if the new accounting policy had always been applied. However, since the IFRS for SMEs does not allow the use of the revaluation model for property, plant and equipment, this is not relevant in this case.

The same principles apply under FRS 102. However, the initial application of a policy to revalue assets is a change in accounting policy to be dealt with as a revaluation in accordance with the relevant sections (s.17), rather than in accordance with the paragraphs above. This essentially means that the new policy is applied only from that date forward, that is prospectively.

4 (a) (i) The definition of what constitutes a contract for the purpose of applying the standard is critical. The definition of a contract is based on the definition of a contract in the USA and is similar to that in IAS 32 *Financial Instruments: Presentation*. A contract exists when an agreement between two or more parties creates enforceable rights and obligations between those parties. The agreement does not need to be in writing to be a contract but the decision as to whether a contractual right or obligation is enforceable is considered within the context of the relevant legal framework of a jurisdiction. Thus whether a contract is enforceable will vary across jurisdictions. The performance obligation could include promises which result in a valid expectation that the entity will transfer goods or services to the customer even though those promises are not legally enforceable.

The first criteria set out in IFRS 15 are that the parties should have approved the contract and are committed to perform their respective obligations. It would be questionable whether that contract is enforceable if this were not the case. In the case of oral or implied contracts, this may be difficult but all relevant facts and circumstances should be considered in assessing the parties' commitment. The parties need not always be committed to fulfilling all of the obligations under a contract. IFRS 15 gives the example where a customer is required to purchase a minimum quantity of goods but past experience shows that the customer does not always do this and the other party does not enforce their contract rights. However, there needs to be evidence that the parties are substantially committed to the contract.

It is essential that each party's rights and the payment terms can be identified regarding the goods or services to be transferred. This latter requirement is the key to determining the transaction price.

The contract must have commercial substance before revenue can be recognised as without this requirement, entities might artificially inflate their revenue and it would be questionable whether the transaction has economic consequences. Further, it should be probable that the entity will collect the consideration due under the contract. An assessment of a customer's credit risk is an important element in deciding whether a contract has validity but customer credit risk does not affect the measurement or presentation of revenue. The consideration may be different to the contract price because of discounts and bonus offerings. The entity should assess the ability of the customer to pay and the customer's intention to pay the consideration. If a contract with a customer does not meet these criteria, the entity can continually re-assess the contract to determine whether it subsequently meets the criteria.

Two or more contracts which are entered into around the same time with the same customer may be combined and accounted for as a single contract, if they meet the specified criteria. The standard provides detailed requirements for contract modifications. A modification may be accounted for as a separate contract or a modification of the original contract, depending upon the circumstances of the case.

(ii) Step one in the five-step model requires the identification of the contract with the customer. After a contract has been determined to fall under IFRS 15, the following steps are required before revenue can be recognised.

Step two requires the identification of the separate performance obligations in the contract. This is often referred to as 'unbundling', and is done at the beginning of a contract. The key factor in identifying a separate performance obligation is the distinctiveness of the good or service, or a bundle of goods or services. A good or service is distinct if the customer can benefit from the good or service on its own or together with other readily available resources and is separately identifiable from other elements of the contract. IFRS 15 requires a series of distinct goods or services which are substantially the same with the same pattern of transfer, to be regarded as a single performance obligation. A good or service, which has been delivered, may not be distinct if it cannot be used without another good or service which has not yet been delivered. Similarly, goods or services which are not distinct should be combined with other goods or services until the entity identifies a bundle of goods or services which is distinct. IFRS 15 provides indicators rather than criteria to determine when a good or service is distinct within the context of the contract. This allows management to apply judgement to determine the separate performance obligations which best reflect the economic substance of a transaction.

Step three requires the entity to determine the transaction price, which is the amount of consideration which an entity expects to be entitled to in exchange for the promised goods or services. This amount excludes amounts collected on behalf of a third party, for example, government taxes. An entity must determine the amount of consideration to which it expects to be entitled in order to recognise revenue.

The transaction price might include variable or contingent consideration. Variable consideration should be estimated as either the expected value or the most likely amount. Management should use the approach which it expects will best predict the amount of consideration and should be applied consistently throughout the contract. An entity can only include variable consideration in the transaction price to the extent that it is highly probable that a subsequent change in the estimated variable consideration will not result in a significant revenue reversal. If it is not appropriate to include all of the variable consideration in the transaction price, the entity should assess whether it should include part of the variable consideration. However, this latter amount still has to pass the 'revenue reversal' test.

Additionally, an entity should estimate the transaction price taking into account non-cash consideration, consideration payable to the customer and the time value of money if a significant financing component is present. The latter is not required if the time period between the transfer of goods or services and payment is less than one year. If an entity anticipates that it may ultimately accept an amount lower than that initially promised in the contract due to, for example, past experience of discounts given, then revenue would be estimated at the lower amount with the collectability of that lower amount being assessed. Subsequently, if revenue already recognised is not collectable, impairment losses should be taken to profit or loss.

Step four requires the allocation of the transaction price to the separate performance obligations. The allocation is based on the relative standalone selling prices of the goods or services promised and is made at inception of the contract. It is not adjusted to reflect subsequent changes in the standalone selling prices of those goods or services. The best evidence of standalone selling price is the observable price of a good or service when the entity sells that good or service separately. If that is not available, an estimate is made by using an approach which maximises the use of observable inputs. For example, expected cost plus an appropriate margin or the assessment of market prices for similar goods or services adjusted for entity-specific costs and margins or in limited circumstances a residual approach. When a contract contains more than one distinct performance obligation, an entity allocates the transaction price to each distinct performance obligation on the basis of the standalone selling price.

Where the transaction price includes a variable amount and discounts, consideration needs to be given as to whether these amounts relate to all or only some of the performance obligations in the contract. Discounts and variable consideration will typically be allocated proportionately to all of the performance obligations in the contract. However, if certain conditions are met, they can be allocated to one or more separate performance obligations.

Step five requires revenue to be recognised as each performance obligation is satisfied. An entity satisfies a performance obligation by transferring control of a promised good or service to the customer, which could occur over time or at a point in time. The definition of control includes the ability to prevent others from directing the use of and obtaining the benefits from the asset. A performance obligation is satisfied at a point in time unless it meets one of three criteria set out in IFRS 15. Revenue is recognised in line with the pattern of transfer.

If an entity does not satisfy its performance obligation over time, it satisfies it at a point in time and revenue will be recognised when control is passed at that point in time. Factors which may indicate the passing of control include the present right to payment for the asset or the customer has legal title to the asset or the entity has transferred physical possession of the asset.

(b) (i) The contract contains a significant financing component because of the length of time between when the customer pays for the asset and when Tang transfers the asset to the customer, as well as the prevailing interest rates in the market. A contract with a customer which has a significant financing component should be separated into a revenue component (for the notional cash sales price) and a loan component. Consequently, the accounting for a sale arising from a contract which has a significant financing component should be comparable to the accounting for a loan with the same features. An entity should use the discount rate which would be reflected in a separate financing transaction between the entity and its customer at contract inception. The interest rate implicit in the transaction may be different from the rate to be used to discount the cash flows, which should be the entity's incremental borrowing rate. IFRS 15 would therefore dictate that the rate which should be used in adjusting the promised consideration is 5%, which is the entity's incremental borrowing rate, and not 11·8%.

Tang would account for the significant financing component as follows:

Recognise a contract liability for the $240,000 payment received on 1 December 2014 at the contract inception:

Dr Cash	$240,000
Cr Contract liability	$240,000

During the two years from contract inception (1 December 2014) until the transfer of the printing machine, Tang adjusts the amount of consideration and accretes the contract liability by recognising interest on $240,000 at 5% for two years.

Year to 30 November 2015

Dr Interest expense	$12,000
Cr Contract liability	$12,000

Contract liability would stand at $252,000 at 30 November 2015.

Year to 30 November 2016

Dr Interest expense	$12,600
Cr Contract liability	$12,600

Recognition of contract revenue on transfer of printing machine at 30 November 2016 of $264,600 by debiting contract liability and crediting revenue with this amount.

(ii) Tang accounts for the promised bundle of goods and services as a single performance obligation satisfied over time in accordance with IFRS 15. At the inception of the contract, Tang expects the following:

Transaction price	$1,500,000
Expected costs	$800,000
Expected profit (46·7%)	$700,000

At contract inception, Tang excludes the $100,000 bonus from the transaction price because it cannot conclude that it is highly probable that a significant reversal in the amount of cumulative revenue recognised will not occur. Completion of the printing machine is highly susceptible to factors outside the entity's influence. By the end of the first year, the entity has satisfied 65% of its performance obligation on the basis of costs incurred to date. Costs incurred to date are

therefore $520,000 and Tang reassesses the variable consideration and concludes that the amount is still constrained. Therefore at 30 November 2015, the following would be recognised:

Revenue	$975,000
Costs	$520,000
Gross profit	$455,000

However, on 4 December 2015, the contract is modified. As a result, the fixed consideration and expected costs increase by $110,000 and $60,000, respectively. The total potential consideration after the modification is $1,710,000 which is $1,610,000 fixed consideration + $100,000 completion bonus. In addition, the allowable time for achieving the bonus is extended by six months with the result that Tang concludes that it is highly probable that including the bonus in the transaction price will not result in a significant reversal in the amount of cumulative revenue recognised in accordance with IFRS 15. Therefore the bonus of $100,000 can be included in the transaction price. Tang also concludes that the contract remains a single performance obligation. Thus, Tang accounts for the contract modification as if it were part of the original contract. Therefore Tang updates its estimates of costs and revenue as follows:

Tang has satisfied 60·5% of its performance obligation ($520,000 actual costs incurred compared to $860,000 total expected costs). The entity recognises additional revenue of $59,550 [(60·5% of $1,710,000) – $975,000 revenue recognised to date] at the date of the modification as a cumulative catch-up adjustment. As the contract amendment took place after the year end, the additional revenue would not be treated as an adjusting event.

				Marks
1	**(a)**	Share capital		1
		Goodwill Salt		1
		Intra-group loan		2
		Translation and exchange differences Tyslar		6
		Pension		4
		Property, plant and equipment		3
		Inventories		1
		Intra-group balances		2
		Other components of equity		3
		Retained earnings		6
		Non-controlling interest		3
		Non-current liabilities		2
		Current liabilities		1
				35
	(b)	1 mark per sensible comment		9
	(c)	1 mark per sensible comment		6
				50
2	**(a)**	1 mark per point up to maximum		8
	(b)	1 mark per point up to maximum		6
	(c)	1 mark per point up to maximum		9
	Professional marks			2
				25
3	**(a)**	**(i)**	1 mark per point up to maximum	9
		(ii)	1 mark per point up to maximum	6
	(b)	**(i)**	1 mark per point up to maximum	4
		(ii)	1 mark per point up to maximum	4
	Professional marks			2
				25
4	**(a)**	**(i)**	1 mark per point up to maximum	5
		(ii)	1 mark per point	8
	(b)	**(i)**	1 mark per point up to maximum	4
		(ii)	1 mark per point up to maximum	6
	Professional marks			2
				25