Answers

1 (a) Kutchen

Consolidated statement of financial position at 31 March 2015

	$m
Assets:	
Non-current assets	
Property, plant and equipment (W6)	314·00
Goodwill (W2)	26·06
Finance lease receivable (W7)	71·80
	411·86
Current assets (44 + 25 + 64)	133
Total assets	544·86
Equity and liabilities:	
Share capital (43 + 20)	63
Retained earnings (W4)	50·05
Other components of equity (W4)	25·4
	138·45
Non controlling interest (W5)	33·06
Total equity	171·51
Non-current liabilities (W8)	101·35
Current liabilities (W9)	
Trade and other payables	272
Total current liabilities	272
Total liabilities	373·35
Total equity and liabilities	544·86

Working 1

House

	$m	$m
Fair value of consideration for 70% interest	42	
Fair value of non-controlling interest	16·38	58·38
Fair value of identifiable net assets acquired		(48)
Goodwill		10·38

Contingent consideration should be valued at fair value and will have to take into account the various milestones set under the agreement. The expected value is (20% x 5 million shares) 1 million shares x $2, i.e. $2 million. There will be no remeasurement of the fair value in subsequent periods. If this were a liability, there would be remeasurement. The contingent consideration will be shown in OCE. The fair value of the consideration is therefore 20 million shares at $2 plus $2 million (above), i.e. $42 million.

The purchase should be accounted for as follows:

Dr Investment in House	$42 million
Cr Ordinary share capital	$20 million
Cr Other components of equity	$22 million

The fair value of the NCI is 30% x 13 million x $4·20 = $16·38 million

The fair value adjustment for land is $(48 – Share capital 13 – Retained earnings 18 – OCE 3)m, i.e. $14 million.

Working 2

Mach

Net profit of Mach for the year to 31 March 2014 is $3·6 million. The P/E ratio (adjusted) is 19. Therefore the fair value of Mach is 19 x $3·6 million, i.e. $68·4 million. The NCI has a 20% holding; therefore the fair value of the NCI is $13·68 million.

	$m	$m
Fair value of consideration for 80% interest ($52m + $5m)	57	
Fair value of non-controlling interest	13·68	70·68
Fair value of identifiable net assets acquired		(55)
Goodwill		15·68

The land transferred as part of the purchase consideration should be valued at its acquisition date fair value of $5 million. Therefore the increase of $2 million over the carrying amount should be shown in retained earnings.

The fair value adjustment for land is $13m (55 – Share capital 26 – Retained earnings 12 – OCE 4), i.e. $13 million.

Total goodwill is therefore $(15·68 + 10·38) million, i.e. $26·06 million.

Working 3

Niche

	$m
Gain/(Loss) in group financial statements on sale of Niche	
Sale proceeds	50
Less	
Share of identifiable net assets at date of disposal (80% x $60 million)	(48)
Goodwill $(40m – (80% of $44m) – impairment $2m)	(2·8)
Loss on sale of Niche	(0·8)
Post-acquisition profits	
($60m – $44m) x 80% – impairment $2m	10·8
Profit reported in OCE to be transferred to retained earnings	10

The net effect of the above is to transfer $10 million from OCE to retained earnings.

Working 4

Retained earnings

	$m
Kutchen:	
Balance at 31 March 2015	41
Gain on land given as consideration for Mach (W2)	2
Loss on sale of Niche (W3)	(0·8)
Post-acquisition profits – Niche (W3)	10·8
Pension payment – loss (W8)	(1·6)
Negative past service cost (W8)	2
Restructuring provision (W8)	(6)
Deferred tax asset (W8)	1·25
Impairment of building (W8)	(5)
Finance lease – revenue (W7)	(3)
Finance lease – cost of sales (W7)	2·8
Post-acquisition reserves: House (70% x 24 – 18)	4·2
Mach (80% x 15 – 12)	2·4
	50·05

Kutchen: other components of equity	$m
Balance at 31 March 2015	12
Purchase of House (W1)	22
Post-acquisition reserves – House (70% x (5 – 3))	1·4
– Mach (80% x 4 – 4))	–
Loss on sale of Niche to retained earnings (W3)	0·8
Post-acquisition profits to retained earnings (W3)	(10·8)
	25·4

Working 5

Non-controlling interest

	$m
House – fair value at 1 October 2014 (W1)	16·38
Post-acquisition reserves	
Retained earnings (30% x (24 – 18))	1·8
OCE (30% x (5 – 3))	0·6
Mach – fair value 1 April 2014 (W2)	13·68
Retained earnings (20% x (15 – 12))	0·6
OCE (20% x (4 – 4))	–
Total	33·06

Working 6

Property, plant and equipment

	$m	$m
Kutchen	216	
House	41	
Mach	38	
		295
Increase in value of land – House (W1)		14
Increase in value of land – Mach (W2)		13
Sale of land as consideration for Mach (W2)		(3)
Impairment of building (W8)		(5)
		314·0

Working 7

Finance lease

Kutchen should have shown the lease receivable at the lower of the fair value of the asset and the present value of the minimum lease payments, i.e. $47 million. Therefore an adjustment of $3 million will have to be made to profit or loss and the lease receivable. Similarly, the cost of transaction should have been $(40 – 2·8) million, i.e. $37·2 million as the asset reverts back to Kutchen at the end of the lease. Therefore an adjustment should be made to profit or loss and lease receivable of $2·8 million.

Dr Profit or loss	$3 million
Cr Lease receivable	$3 million
Dr Lease receivable	$2·8 million
Cr Profit or loss	$2·8 million

(The net amount of $0·2 million could be adjusted in this case.)

The finance lease receivable figure in the financial statements will be $(50 – 3 + 2·8 + 14 + 8)m, i.e. $71·8 million.

Working 8

Non-current liabilities

	$m	$m
Kutchen	67	
House	12	
Mach	28	
		107
Reduction of pension obligation (2 + 2·4)		(4·4)
Deferred tax asset		(1·25)
		101·35

Pensions

After restructuring, the present value of the pension liability in location 1 is reduced to $8 million. Thus there will be a negative past service cost in this location of $(10 – 8) million, i.e. $2 million. As regards location 2, there is a settlement and a curtailment as all liability will be extinguished by the payment of $4 million. Therefore there is a loss of $(2·4 – 4) million, i.e. $1·6 million. The changes to the pension scheme in locations 1 and 2 will both affect profit or loss as follows:

Location 1

Dr Pension obligation	\$2m
Cr Retained earnings	\$2m

Location 2

Dr Pension obligation	\$2·4m
Dr Retained earnings	\$1·6m
Cr Current liabilities	\$4m

Even though there has been no formal announcement of the restructuring, Kutchen has started implementing it and therefore it must be accounted for under IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.

A provision of \$6 million should also be made at the year end.

Deferred taxation and impairment

Carrying amount of building at 31 March 2015 \$(25 – 1 depreciation) million, i.e. 24 million dinars/2 = \$12 million.

Recoverable amount of building at 31 March 2015 17·5 million dinars/2·5 = \$7 million.

Impairment loss to profit or loss = \$5 million.

The tax base and carrying amount of the non-current assets are the same before the impairment charge. After the impairment charge, there will be a difference of \$5 million. This will create a deferred tax asset of \$5 million x 25%, i.e. \$1·25 million. As Kutchen expects to make profits for the foreseeable future, this can be recognised in the financial statements.

Working 9

Current liabilities

	\$m	\$m
Kutchen	199	
House	26	
Mach	37	
		262
Pension payment		4
Restructuring provision		6
		272

(b) The requirements in the Companies Act 2006 to prepare group accounts are largely mirrored in FRS 102, which states that consolidated financial statements (group accounts in the Companies Act) are prepared by all parent entities unless one of the following exemptions which are derived from the Companies Act applies:

(i) The parent company is subject to the small companies regime (see ss.383 to 384 of the Companies Act).

(ii) The parent company is a subsidiary included in a larger group which prepares consolidated financial statements and meets the requirements of ss.400 or 401 of the Companies Act, including:

(a) The parent is itself a subsidiary whose immediate parent is established in an EEA state, and whose results are consolidated into the group financial statements of an undertaking established in an EEA state (not necessarily the immediate parent). Section 400 sets out further conditions for this exemption, including that a company which has any of its securities admitted to trading on a regulated market in an EEA state is not eligible for this exemption.

(b) The parent is itself a subsidiary, its immediate parent is not established in an EEA state, and its results are consolidated into the group accounts of an undertaking (either the same parent or another) drawn up in accordance with the EU Seventh Directive or in an equivalent manner (for example, EU-IFRS accounts).

Section 401 sets out further conditions for this exemption, including that a company which has any of its securities admitted to trading on a regulated market in an EEA state is not eligible for this exemption.

(iii) All of the parent's subsidiaries are excluded from consolidation under FRS 102.

If an entity is not a parent at the year end, then it is not required to prepare consolidated accounts.

Exclusion of subsidiaries from consolidation

Consolidated financial statements provide information about the group as a single economic entity. They include all subsidiaries of the parent except those excluded on one of the following grounds:

(a) severe long-term restrictions substantially hinder the exercise of the rights of the parent over the assets or management of the subsidiary. These rights are the rights held by or attributed to the company in the absence of which it would not be the parent company; or

(b) the subsidiary is held exclusively for resale and has not previously been included in the consolidation.

A subsidiary excluded from consolidation due to severe long-term restrictions is, if the parent still exercises significant influence, equity accounted and treated as an associate. Otherwise, the parent has a choice of accounting policy to measure the subsidiary either at cost less impairment, or at fair value through other comprehensive income (OCI) with movements below cost recorded in profit or loss or at fair value through profit or loss.

A subsidiary excluded from consolidation on the basis of not previously having been consolidated and being held exclusively for resale is accounted for in accordance with FRS 102, which gives a choice of accounting policy of either cost less impairment, fair value through OCI with movements below cost recorded in profit or loss or fair value through profit or loss unless it is held as part of an investment portfolio. If it is held as part of an investment portfolio, it is held at fair value through profit or loss.

Section 405 of the Companies Act states that a subsidiary may be excluded from consolidation if the necessary information to prepare the group accounts cannot be obtained without disproportionate expense or undue delay. FRS 102, however, states that this does not justify non-consolidation, effectively closing off the statutory option. Subsidiaries are not excluded from consolidation because the subsidiary has dissimilar business activities to the rest of the group.

(c) The IASB emphasises the fundamental importance of standards which focus on principles, drawn clearly from the IASB's Conceptual Framework, rather than on detailed rules. This approach requires both companies and their auditors to exercise professional judgement in the public interest, by requiring preparers to develop financial statements which provide a faithful representation of all transactions and requiring auditors to resist client pressures. The US financial reporting model is based largely on principles, but supplemented by extensive rules and regulations. Companies want detailed guidance because those details eliminate uncertainties about how transactions should be structured, and auditors want specificity because those specific requirements limit the number of difficult disputes with clients and may provide defence in litigation.

The IASB has indicated that a body of detailed guidance encourages a rulebook mentality and it often helps those who are intent on finding ways around standards. The detailed guidance may obscure, rather than highlight, the underlying principles, since the emphasis is often on compliance with the 'letter' of the rule rather than on the 'spirit' of the accounting standard.

Moving from a rules-based system of accounting standards to a principles-based system could create ethical challenges for accountants. More professional judgement would be needed, which could be perceived as creating potential ethical grey areas. However, whilst IFRS tend to use more of a principles-based approach, this, in turn, requires accountants to have a complete understanding of ACCA's ethical principles and possess an ability to apply those principles effectively using a personal decision-making process. Accountants are required to appreciate the critical role ethics serves in the accounting profession and work continually in improving their process for recognising and thinking through ethical issues. The ethical conduct of an accountant should not be influenced by the nature of the accounting principles and practices, which are being complied with.

Convergence of accounting principles is an important part of the IASB's work plan and road map for adoption of a single set of high quality globally accepted accounting standards. It follows therefore that there should be global convergence on the subject of an independent accountant's ethical responsibility for assuring that financial statements do in fact fairly present economic reality.

There is no doubt that where a rules-based system has been in operation, there is likely to be an expansion of ethical challenges for both accountants and auditors involved with the financial statements of public companies if a principles-based approach was adopted. For example, the litigious atmosphere which businesses face in the US could lead to poor application of IFRS because of pressures relating to potential litigation. However, it is up to the accounting profession to ensure that ethical practices ensure high quality financial statements. Initially, accountants may face ethical pressures from management to develop and follow a rationale for seeing the financial results of their organisation in absolutely the most favourable light, because of the apparent elimination of accounting rules. However, IFRS are a robust set of accounting standards and it is unrealistic to assume that these standards could not replace those based around rules.

2 **(a)** IFRS 13 says that fair value is an exit price in the principal market, which is the market with the highest volume and level of activity. It is not determined based on the volume or level of activity of the reporting entity's transactions in a particular market. Once the accessible markets are identified, market-based volume and activity determines the principal market. There is a presumption that the principal market is the one in which the entity would normally enter into a transaction to sell the asset or transfer the liability, unless there is evidence to the contrary. In practice, an entity would first consider the markets it can access. In the absence of a principal market, it is assumed that the transaction would occur in the most advantageous market. This is the market which would maximise the amount which would be received to sell an asset or minimise the amount which would be paid to transfer a liability, taking into consideration transport and transaction costs. In either case, the entity must have access to the market on the measurement date. Although an entity must be able to access the market at the measurement date, IFRS 13 does not require an entity to be able to sell the particular asset or transfer the particular liability on that date. If there is a principal market for the asset or liability, the fair value measurement represents the price in that market at the measurement date regardless of whether that price is directly observable or estimated using another valuation technique and even if the price in a different market is potentially more advantageous.

The principal (or most advantageous) market price for the same asset or liability might be different for different entities and therefore, the principal (or most advantageous) market is considered from the entity's perspective which may result in different prices for the same asset.

In Yanong's case, Asia would be the principal market as this is the market in which the majority of transactions for the vehicles occur. As such, the fair value of the 150 vehicles would be $5,595,000 ($38,000 – $700 = $37,300 x 150). Actual sales of the vehicles in either Europe or Africa would result in a gain or loss to Yanong when compared with the fair value, i.e. $37,300. The most advantageous market would be Europe where a net price of $39,100 (after all costs) would be gained by selling there and the number of vehicles sold in this market by Yanong is at its highest. Yanong would therefore utilise the fair value calculated by reference to the Asian market as this is the principal market.

The IASB decided to prioritise the price in the most liquid market (i.e. the principal market) as this market provides the most reliable price to determine fair value and also serves to increase consistency among reporting entities.

IFRS 13 makes it clear that the price used to measure fair value must not be adjusted for transaction costs, but should consider transportation costs. Yanong has currently deducted transaction costs in its valuation of the vehicles. Transaction costs are not deemed to be a characteristic of an asset or a liability but they are specific to a transaction and will differ depending on how an entity enters into a transaction. While not deducted from fair value, an entity considers transaction costs in the context of determining the most advantageous market because the entity is seeking to determine the market which would maximise the net amount which would be received for the asset.

(b) Where reliable market-based prices or values are not available for a biological asset in its present location and condition, fair value should be measured using a valuation technique. Relevant observable inputs should be maximised whilst unobservable inputs should be minimised (IFRS 13 *Fair Value Measurement*). An appropriate valuation technique would be the present value of expected net cash flows from the asset, discounted at a current market-based rate. In the measurement of fair value of growing crops, a notional cash flow expense should be included for the 'rent' of the land where it is owned in order that the value is comparable to an entity which rents its land. The fair value of the biological asset is separate from the value of the land on which it grows.

	3 months to 31 January 2015 $ million	3 months to 30 April 2015 $ million	Total $ million
Cash inflows		80	80
Cash outflows	(8)	(19)	(27)
Notional rental charge for land	(1)	(1)	(2)
Net cash flows	(9)	60	51
Discounted at 2%	(8·82)	57·67	48·85

Thus in the quarterly accounts at 31 October 2014, the maize fields should be recognised at $68·85 million ($20 million land plus $48·85 million maize). A fair value gain of $48·85 million should be shown in profit or loss less the operating costs of $10 million.

At 31 January, Yanong has revised its projections for cash inflows to $76 million, which means that the net cash flows at that date were projected to be $(76 – 19 – 1) million, i.e. $56 million. Discounted at 2%, this amounts to $54·9 million. Thus a fair value gain of $(54·9 – 48·85) million, i.e. $6·05 million, should be shown in profit or loss together with the actual operating costs of $8 million.

At the point of harvest, on 31 March 2015, the maize is valued at $82 million which means that a fair value gain of $(82 – 54·9) million, i.e. $27·1 million, is recognised in profit or loss and the maize is classified as inventory. The actual operating costs for the quarter would also be shown in profit or loss. When the maize is sold, a further profit of $(84 – 82) million, i.e. $2 million, is made on sale.

(c) IFRS 13 applies when another IFRS requires or permits fair value measurements or disclosures about fair value measurements (and measurements, such as fair value less costs to sell, based on fair value or disclosures about those measurements). IFRS 13 specifically excludes transactions covered by certain other standards including share-based payment transactions within the scope of IFRS 2 *Share-based Payment* and leasing transactions within the scope of IAS 17 *Leases*.

Thus share-based payment transactions are scoped out of IFRS 13.

For cash settled share-based payment transactions, the fair value of the liability is measured in accordance with IFRS 2 initially, at each reporting date and at the date of settlement using an option pricing model. The measurement reflects all conditions and outcomes on a weighted average basis, unlike equity settled transactions. Any changes in fair value are recognised in profit or loss in the period. Therefore, the SARs would be accounted for as follows:

Year	Expense $	Liability $	Calculation	
30 April 2013	641,250	641,250	285 x 500 x $9 x ½	Time apportioned over vesting period. Using the estimated (300 x 95%) 285 managers.
30 April 2014	926,250	1,567,500	285 x 500 x $11	Expense is difference between liabilities at 30 April 2014 and 30 April 2013
30 April 2015	97,500	1,350,000	225 x 500 x $12	Cash paid is 60 x 500 x $10·50, i.e. $315,000. The liability has reduced by $217,500 and therefore the expense is the difference of $97,500

The fair value of the liability would be $1,350,000 at 30 April 2015 and the expense for the year would be $97,500.

Tutorial note:

SARs exercised:
30 April 2015: 60 x $10·50 x 500 = $315,000
30 April 2014: 60 x $11 x 500 = $330,000

Therefore a gain of $15,000 is made on these SARs.

Unexercised SARs:
30 April 2015: 225 x $12 x 500 = $1,350,000
30 April 2014: 225 x $11 x 500 = $1,237,500

Therefore a loss of $112,500 is made on the remaining unexercised SARs.

This results in an overall charge to profit or loss for the year ended 30 April 2015 of $97,500.

(d) A fair value measurement of a non-financial asset takes into account a market participant's ability to generate economic benefits by using the asset in its highest and best use or by selling it to another market participant who would use the asset in its highest and best use. The maximum value of a non-financial asset may arise from its use in combination with other assets or by itself. IFRS 13 requires the entity to consider uses which are physically possible, legally permissible and financially feasible. The use must not be legally prohibited. For example, if the land is protected in some way by law and a change of law is required, then it cannot be the highest and best use of the land. In this case, Yanong's land for residential development would only require approval from the regulatory authority and that approval seems to be possible, then this alternative use could be deemed to be legally permissible. Market participants would consider the probability, extent and timing of the approval which may be required in assessing whether a change in the legal use of the non-financial asset could be obtained.

Yanong would need to have sufficient evidence to support its assumption about the potential for an alternative use, particularly in light of IFRS 13's presumption that the highest and best use is an asset's current use. Yanong's belief that planning permission was possible is unlikely to be sufficient evidence that the change of use is legally permissible. However, the fact the government has indicated that more agricultural land should be released for residential purposes may provide additional evidence as to the likelihood that the land being measured should be based upon residential value. Yanong would need to prove that market participants would consider residential use of the land to be legally permissible. Provided there is sufficient evidence to support these assertions, alternative uses, for example, commercial development which would enable market participants to maximise value, should be considered, but a search for potential alternative uses need not be exhaustive. In addition, any costs to transform the land, for example, obtaining planning permission or converting the land to its alternative use, and profit expectations from a market participant's perspective should also be considered in the fair value measurement.

If there are multiple types of market participants who would use the asset differently, these alternative scenarios must be considered before concluding on the asset's highest and best use. It appears that Yanong is not certain about what constitutes the highest and best use and therefore IFRS 13's presumption that the highest and best use is an asset's current use appears to be valid at this stage.

3 (a) IFRS 8 *Operating Segments* states that an operating segment is a component of an entity which engages in business activities from which it may earn revenues and incur costs. In addition, discrete financial information should be available for the segment and these results should be regularly reviewed by the entity's chief operating decision maker (CODM) when making decisions about resource allocation to the segment and assessing its performance. However, if a function is an integral part of the business, it may be disclosed as a segment even though it may not earn revenue.

Other factors should be taken into account when identifying the operating segments. These include the nature of the business activities of each component, the existence of managers responsible for them, and information presented to the board of directors.

IFRS 8 also has certain quantitative measures to identify a segment, although an entity can report segment information for smaller operating segments if there is a belief that the information is useful.

According to IFRS 8, an operating segment is one which meets any of the following quantitative thresholds:

(a) Its reported revenue, including both sales to external customers and intersegment sales or transfers, is 10% or more of the combined revenue, internal and external, of all operating segments.

(b) The absolute amount of its reported profit or loss is 10% or more of the greater, in absolute amount, of (i) the combined reported profit of all operating segments which did not report a loss and (ii) the combined reported loss of all operating segments which reported a loss.

(c) Its assets are 10% or more of the combined assets of all operating segments.

As regards the two research and development laboratories, qualitative and quantitative factors should be considered in determining the operating segments. The qualitative factors will include whether the resultant operating segments are consistent with the principles of IFRS 8, whether the operating segments represent the level at which the CODM is assessing performance and allocating resources and whether the identified operating segments enable users of its financial statements to evaluate its activities and financial performance, and the business environment it operates in.

As a result of the application of the above criteria, the first laboratory will not be reported as a separate operating segment. The divisions have heads directly accountable to, and maintaining regular contact with, the CODM to discuss all aspects of their division's performance. The divisions seem to be consistent with the core principle of IFRS 8 and should be reported as separate segments. The laboratory does not have a separate segment manager and the existence of a segment manager is normally an important factor in determining operating segments. Instead, the laboratory is responsible to the divisions themselves, which would seem to indicate that it is simply supporting the existing divisions and not a separate segment. Additionally, there does not seem to be any discrete performance information for the segment, which is reviewed by the CODM.

The second laboratory should be reported as a separate segment. It meets the quantitative threshold for percentage of total revenues and it meets other criteria for an operating segment. It engages in activities which earn revenues and incurs costs, its operating results are reviewed by the CODM and discrete information is available for the laboratory's activities. Finally, it has a separate segment manager.

(b) All equity investments in the scope of IFRS 9 *Financial Instruments* are to be measured at fair value in the statement of financial position, with value changes recognised in profit or loss, except for those equity investments for which the entity has elected to report value changes in 'other comprehensive income'. If an equity investment is not held for trading, an entity can make an irrevocable election at initial recognition to measure it at fair value through other comprehensive income with only dividend income recognised in profit or loss. Despite the fair value requirement for all equity investments, IFRS 9 contains guidance on when cost may be the best estimate of fair value and also when it might not be representative of fair value. IFRS 13 *Fair Value Measurement* defines fair value in this case which would be the price which would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Klancet would use level 1 inputs in this case, which are quoted prices in active markets.

Klancet's management should initially recognise the shares received at their fair value and should also derecognise the patent which is transferred to Jancy. Any gain or loss should also be recognised. The fair value of the shares received represents the amount of the consideration received according to IAS 18 *Revenue*. Revenue from royalties will be recognised on an accrual basis in accordance with the substance of the relevant agreement (IAS 18). As such, Klancet should not yet recognise any asset relating to the future royalty stream from the potential sales of the drug, because this stream of royalties is contingent upon the successful development of the drug.

With regards to the purchase of the patent, this is an equity settled, share-based payment transaction. The rules from IFRS 2 *Share-based Payment* should be used.The entity should measure the goods purchased at the fair value of the goods received, unless that fair value cannot be estimated reliably. If Klancet cannot estimate reliably the fair value of the goods received, it should measure the value by reference to the fair value of the equity instruments granted. Klancet should recognise the patent at its fair value. The best indicator of fair value is the publicly traded price of the shares on the acquisition date.

(c) Under IFRS for SMEs, all research and development costs are recognised as an expense. No intangible assets would therefore be recognised in respect of either of these contracts during the research and development stage.

However, FRS 102 takes a different approach. In assessing whether the recognition criteria are met for an internally generated intangible asset, research and development costs are split into a research phase and a development phase. If an entity cannot distinguish between the two phases, then all expenditure on the project is treated as relating to the research phase. Expenditure relating to the research phase of a project is expensed as incurred. An entity makes an accounting policy choice to capitalise expenditure in the development phase as an intangible asset or recognise it as an expense. If it adopts a policy of capitalisation, this applies to a development if, and only if, the entity can demonstrate that a series of criteria have all been met. These are:

(a) the project is technically feasible;
(b) the entity intends to complete the project and use or sell the intangible asset; the entity is able to sell or use the asset;
(c) it is probable that the asset will generate future economic benefits;
(d) the entity has sufficient resources to complete the project; and
(e) the entity can measure reliably the directly attributable expenditure.

If these criteria are met, then from that date all costs which are directly attributable to creating, producing, and preparing the asset to be capable of operating in the manner intended by management are capitalised.

FRS 102 permits an entity to recognise an intangible asset when it is probable that the entity will receive the expected future economic benefits attributable to the asset, and its cost or value can be measured reliably. This requirement applies whether an intangible asset is acquired externally or generated internally. The price which an entity pays to acquire an intangible asset reflects its expectations about the probability that the expected future economic benefits in the asset will flow to the entity. The effect of probability is reflected in the cost of the asset and the probability recognition criterion above is always considered to be satisfied for separately acquired intangible assets. The cost of a separately acquired intangible asset can usually be measured reliably. This is particularly so when the purchase consideration is in the form of cash or other monetary assets. The cost of a separately acquired intangible asset comprises its purchase price and any directly attributable cost of preparing the asset for its intended use.

In the case of the first project, Coact owns the potential new drug, and Retto is carrying out the development of the drug on its behalf. The risks and rewards of ownership remain with Coact. By paying the initial fee and the subsequent payment to Retto, Coact does not acquire a separate intangible asset, which could be capitalised. The payments represent research and development by a third party, which needs to be expensed over the development period provided that the recognition criteria for internally generated intangible assets are not met. Development costs are capitalised only after technical and commercial feasibility of the asset for sale or use have been established. This means that the entity must intend and be able to complete the intangible asset and either uses it or sells it and be able to demonstrate how the asset will generate future economic benefits. At present, this criterion does not appear to have been met as regulatory authority for the use of the drug has not been given, and in fact, approval has been refused in the past.

In the case of the second project, the drug has already been discovered and therefore the costs are for the development and manufacture of the drug and its slight modification. There is no indication that the agreed prices for the various elements are not at fair value. In particular, the terms for product supply at cost plus profit are consistent with Coact's other supply arrangements. Therefore, Coact may capitalise the upfront purchase of the drug and subsequent payments as incurred, and consider impairment at each financial reporting date. Regulatory approval has already been attained for the existing drug and therefore there is no reason to expect that this will not be given for the new drug. Amortisation should begin once regulatory approval has been obtained. Costs for the products have to be accounted for as inventory and then expensed as costs of goods sold as incurred.

4 (a) (i) IAS 1 *Presentation of Financial Statements* defines profit or loss as 'the total of income less expenses, excluding the components of other comprehensive income' and other comprehensive income as comprising 'items of income and expense (including reclassification adjustments) that are not recognised in profit or loss as required or permitted by other IFRSs'. IFRS currently requires the statement of profit or loss and other comprehensive income to be presented as either one statement, being a combined statement of profit or loss and other comprehensive income or two statements, being the statement of profit or loss and the statement of comprehensive income. An entity has to show separately in OCI, those items which would be reclassified (recycled) to profit or loss and those items which would never be reclassified (recycled) to profit or loss. The related tax effects have to be allocated to these sections.

IAS 1 states that profit or loss includes all items of income or expense (including reclassification adjustments) except those items of income or expense which are recognised in OCI as required or permitted by IFRS. IAS 1 further states that the other comprehensive income section is required to present line items which are classified by their nature, and grouped between those items which will or will not be reclassified to profit and loss in subsequent periods.

(ii) Reclassification adjustments are amounts recycled to profit or loss in the current period which were recognised in OCI in the current or previous periods. An example of items recognised in OCI which may be reclassified to profit or loss are foreign currency gains on the disposal of a foreign operation and realised gains or losses on cash flow hedges. Those items which may not be reclassified are changes in a revaluation surplus under IAS 16 *Property, Plant and Equipment*, and actuarial gains and losses on a defined benefit plan under IAS 19 *Employee Benefits*. However, there is a general lack of agreement about which items should be presented in profit or loss and in OCI. The interaction between profit or loss and OCI is unclear, especially the notion of reclassification and when or which OCI items should be reclassified. A common misunderstanding is that the distinction is based upon realised versus unrealised gains.

There are several arguments for and against reclassification. If reclassification ceased, then there would be no need to define profit or loss, or any other total or subtotal in profit or loss, and any presentation decisions can be left to specific IFRSs. It is argued that reclassification protects the integrity of profit or loss and provides users with relevant information about a transaction which occurred in the period. Additionally, it can improve comparability where IFRS permits similar items to be recognised in either profit or loss or OCI.

Those against reclassification argue that the recycled amounts add to the complexity of financial reporting, may lead to earnings management and the reclassification adjustments may not meet the definitions of income or expense in the period as the change in the asset or liability may have occurred in a previous period.

The lack of a consistent basis for determining how items should be presented has led to an inconsistent use of OCI in IFRS. Opinions vary but there is a feeling that OCI has become a home for anything controversial because of a lack of clear definition of what should be included in the statement. Many users are thought to ignore OCI, as the changes reported are not caused by the operating flows used for predictive purposes.

A Discussion Paper on the Conceptual Framework is seeking to clarify what distinguishes recognised items of income and expense which are presented in profit or loss from items of income and expense presented in OCI. It further wishes to clarify why items presented in OCI in one period should be reclassified into profit or loss in the same period or a later period. It suggests that the Conceptual Framework should require a profit or loss total or subtotal which also results, or could result, in some items of income or expense being recycled and should limit the use of OCI to items of income or expense resulting from changes in current measures of assets and liabilities (remeasurements). However, not all such remeasurements would be eligible for recognition in OCI.

(iii) The International Integrated Reporting Council (IIRC) has released a framework for integrated reporting. The Framework establishes principles and concepts which govern the overall content of an integrated report. An integrated report sets out how the organisation's strategy, governance, performance and prospects can lead to the creation of value. The IIRC has set out a principles-based framework rather than specifying a detailed disclosure and measurement standard. This enables each company to set out its own report rather than adopting a checklist approach. The integrated report aims to provide an insight into the company's resources and relationships, which are known as the capitals and how the company interacts with the external environment and the capitals to create value. These capitals can be financial, manufactured, intellectual, human, social and relationship, and natural capital but companies need not adopt these classifications. Integrated reporting is built around the following key components:

(i) Organisational overview and the external environment under which it operates
(ii) Governance structure and how this supports its ability to create value
(iii) Business model
(iv) Risks and opportunities and how they are dealing with them and how they affect the company's ability to create value
(v) Strategy and resource allocation
(vi) Performance and achievement of strategic objectives for the period and outcomes
(vii) Outlook and challenges facing the company and their implications
(viii) The basis of presentation needs to be determined including what matters are to be included in the integrated report and how the elements are quantified or evaluated.

The Framework does not require discrete sections to be compiled in the report but there should be a high level review to ensure that all relevant aspects are included. An integrated report should provide insight into the nature and quality of the organisation's relationships with its key stakeholders, including how and to what extent the organisation understands, takes into account and responds to their needs and interests. Further, the report should be consistent over time to enable comparison with other entities.

The IIRC considered the nature of value and value creation. These terms can include the total of all the capitals, the benefit captured by the company, the market value or cash flows of the organisation and the successful achievement of the company's objectives. However, the conclusion reached was that the Framework should not define value from any one particular perspective because value depends upon the individual company's own perspective. It can be shown through movement of capital and can be defined as value created for the company or for others. An integrated report should not attempt to quantify value as assessments of value are left to those using the report.

The report does not contain a statement from those 'charged with governance' acknowledging their responsibility for the integrated report. This may undermine the reliability and credibility of the integrated report. There has been discussion about whether the Framework constitutes suitable criteria for report preparation and for assurance. There is a degree of uncertainty as to measurement standards to be used for the information reported and how a preparer can ascertain the completeness of the report. The IIRC has stated that the prescription of specific measurement methods is beyond the scope of a principles-based framework. The Framework contains information on the principles-based approach and indicates that there is a need to include quantitative indicators whenever practicable and possible. Additionally, consistency of measurement methods across different reports is of paramount importance. There is outline guidance on the selection of suitable quantitative indicators.

There are additional concerns over the ability to assess future disclosures, and there may be a need for confidence intervals to be disclosed. The preparation of an integrated report requires judgement but there is a requirement for the report to describe its basis of preparation and presentation, including the significant frameworks and methods used to quantify or evaluate material matters. Also included is the disclosure of a summary of how the company determined the materiality limits and a description of the reporting boundaries.

A company should consider how to describe the disclosures without causing a significant loss of competitive advantage. The entity will consider what advantage a competitor could actually gain from information in the integrated report, and will balance this against the need for disclosure.

(b) At 30 April 2015, Cloud should write down the steel, in accordance with IAS 2 *Inventories*, to its net realisable value of \$6 million, therefore reducing profit by \$2 million. Cloud should reclassify an equivalent amount of \$2 million from equity to profit or loss. Thus there is no net impact on profit or loss of the write down of inventory. The gain remaining in equity of \$1 million will affect profit or loss when the steel is sold. Therefore on 3 June 2015, the gain on the sale of \$0·2 million with be recognised in profit or loss, and the remaining gain of \$1 million will be transferred to profit or loss from equity.

As regards the property, plant and equipment, at 30 April 2014 there is a revaluation gain of \$4 million being the difference between the carrying amount of \$8 million (\$10 million – \$2 million) and the revalued amount of \$12 million. This revaluation gain is recognised in other comprehensive income.

At 30 April 2015, the asset's value has fallen to \$4 million and the carrying amount of the asset is \$9 million (\$12 million – \$3 million). The entity will have transferred \$1 million from revaluation surplus to retained earnings being the difference between historical cost depreciation of \$2 million and that on the revalued amount depreciation of \$3 million. The revaluation loss of \$5 million will be charged first against the revaluation surplus remaining in equity of (\$4 million – \$1 million), i.e. \$3 million and the balance of \$2 million will be charged against profit or loss.

IAS 1 requires an entity to present a separate statement of changes in equity showing amongst other items, total comprehensive income for the period, reconciliations between the carrying amounts at the beginning and the end of the period for each component of equity, and an analysis of other comprehensive income.

				Marks
1	**(a)**	Property, plant and equipment		4
		Goodwill		7
		Non-current liabilities		2
		Finance lease		3
		Deferred tax		2
		Current assets		1
		Pensions		3
		Retained earnings		6
		Other components of equity		2
		Non-controlling interest		3
		Current liabilities		2
				35
	(b)	1 mark per point up to maximum		8
	(c)	Philosophy		3
		Ethical considerations		4
				50
2	**(a)**	1 mark per point up to maximum		6
	(b)	1 mark per point up to maximum		6
	(c)	1 mark per point up to maximum		6
	(d)	1 mark per point up to maximum		5
	Professional marks			2
				25
3	**(a)**	1 mark per point up to maximum		8
	(b)	1 mark per point up to maximum		7
	(c)	1 mark per point up to maximum		8
	Professional marks			2
				25
4	**(a)**	**(i)**	1 mark per point up to maximum	4
		(ii)	1 mark per point up to maximum	5
		(iii)	1 mark per point up to maximum	8
	(b)	1 mark per point up to maximum		6
	Professional marks			2
				25