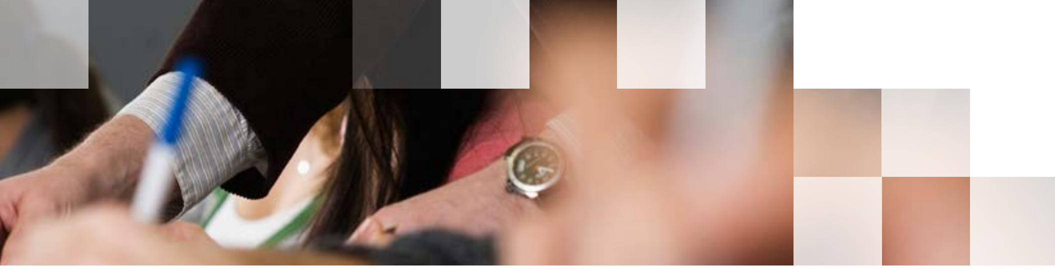
ACCA

Embracing change. Shaping futures.

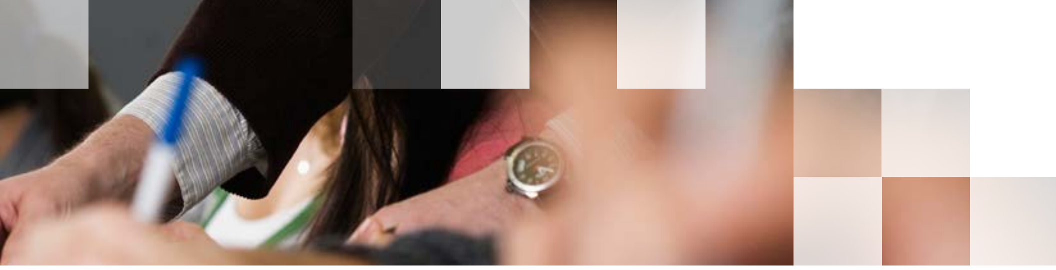
Strategic Business Reporting

Read the mind of an SBR marker – Part 1

Think Ahead



Contents



Introduction

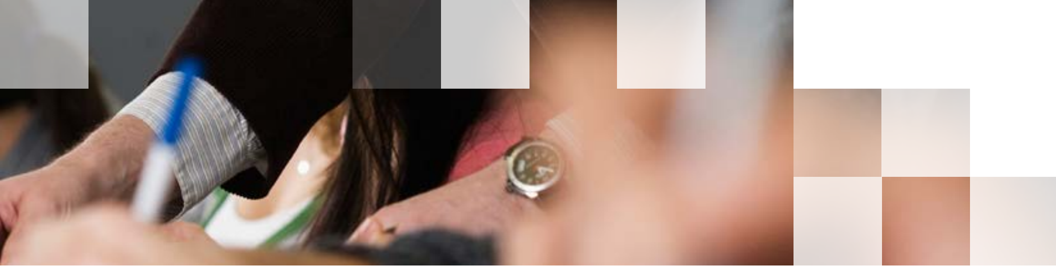
I am a member of the team who will mark Strategic Business Reporting. This article is the first in a series of two, and is designed to give you, the candidate, an insight into my mind, so that you can better understand what a marker will be looking for when it comes to marking your Strategic Business Reporting script.

Insight into a marker's thinking – appreciating what we are trained to look for, what we award marks for, the reasons why marks may not be awarded – will help you fulfil your potential and gain the necessary marks to pass.

> Fulfil your potential and gain the necessary marks to pass.

This article uses two sets of candidates' answers to requirements selected from Section A of the September 2018 exam **click the link here**.

For insight into the marking of questions that can feature in Section B of the SBR exam, please read *Read the mind of an SBR marker – Part 2*.



Question 1

Section A will include two compulsory scenario-based questions, totalling 50 marks.

Question 1 will be based on the financial statements of group entities, or extracts thereof and, in addition, may require consideration of financial reporting issues.

The question may require candidates to prepare calculations from *any* aspect of group accounting (including statements of cash flow). Candidates will be required to discuss the principles behind any calculations they provide and the number of marks allocated to purely numerical answers will be restricted.

Candidates will be required to discuss the principles behind any calculations.

Question 1 in the Specimen exam was for 25 marks. This Question 1 from the September 2018 exam was for 30 marks.

Let's look at requirement (a):

Required:

(a) Draft an explanatory note to the directors of Banana, discussing the following:

(i) how goodwill should have been calculated on the acquisition of Grape and show the accounting entry which is required to amend the financial director's error; **(8 marks)**

(ii) why equity accounting was the appropriate treatment for Strawberry in the consolidated financial statements up to the date of its disposal showing the carrying amount of the investment in Strawberry just prior to disposal; **(4 marks)**

(iii) how the gain or loss on disposal of Strawberry should have been recorded in the consolidated financial statements and how the investment in Strawberry should be accounted for after the part disposal. **(4 marks)**

Note: Any workings can either be shown in the main body of the explanatory note or in an appendix to the explanatory note.

Observations on the requirement

The overall requirement is to discuss. Therefore, although there is a reference to (i) goodwill calculation, (ii) carrying amount and (iii) gain or loss on disposal, candidates should expect more marks to be available for explanation than for workings.

Each requirement must be read carefully to ensure all parts are answered. For example, in (iii):

- [discuss] how the **gain or loss on disposal** of Strawberry should have been recorded in the **consolidated** financial statements **and**
- [discuss] how the **investment** in Strawberry should be accounted for after the part disposal …

Failure to answer all constituent parts will restrict the marks available.

The note prompted that working could be shown in either the main body of the answer or as an appendix. Separate calculations on one page whilst simultaneously explaining them on another page proved an efficient exam technique and many candidates gained high marks for this approach.

Failure to answer all constituent parts will restrict the marks available.

Let's look at the remainder of the question:

(b) Discuss whether the directors are correct to treat Melon as a financial asset acquisition and whether the International Accounting Standards Board's proposed amendments to the definition of a business would revise your conclusions. **(7 marks)**

(c) Discuss how the derecognition requirements of IFRS 9 *Financial Instruments* should be applied to the sale of the bond including calculations to show the impact on the consolidated financial statements for the year ended 30 June 20X7. **(7 marks)**

(30 marks)

Observations on the requirement

Part (b) examines a current issue. As stated in the **Examiner's approach article** 'Within the question that examines current issues, it is likely that Exposure Drafts may be examined in terms of the key areas of change'. It is therefore important to read around the subject. The level of knowledge and understanding required at this level does not come through rote learning but through a deeper understanding and application of the subject matter, through researching websites and articles of standard setters (IASB), the profession and the ACCA.

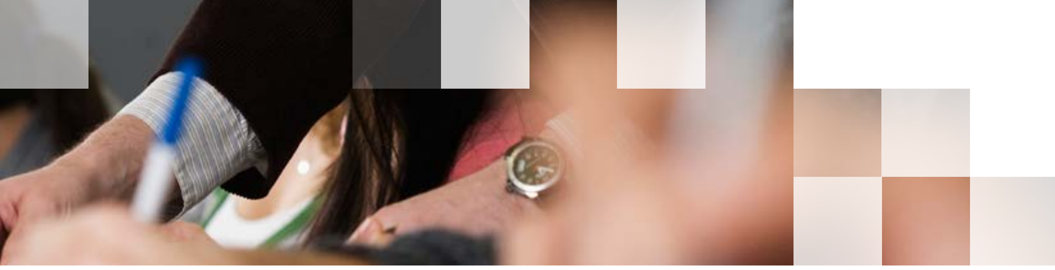
Again, there were two elements to this part:

(1) Discuss whether the director's are correct in their treatment … and

(2) [discuss] whether your conclusion would be revised by the IASB's proposed amendments (i.e. an ED).

Therefore, the 7 marks for this part could reasonably be expected to be allocated as 3 marks for discussion of (1), 1 mark for conclusion on (1) and 3 marks for discussion of (2).

Part (c) called for a discussion of whether a bond sold with favourable repurchase rights should be derecognised under IFRS 9. It also required calculations to show the impact on the financial statements. Marks were available for identifying the key aspect of substance of the transaction.



Notes on candidate one's answer to Q1

Follow this link to see candidate one's answer to Q1

View it here

Note 1
Such a basic working does not need to be presented at this level. The candidate could have simply highlighted this on their question paper.

Note 2
One mark awarded for identifying the fair value (FV) adjustment. As net assets at the acquisition date had already been totalled at $70m in the question scenario, this working was superfluous.

Note 3
One mark awarded for the expected value of the present value of the contingent consideration ($4m). The amount of goodwill is, however, incorrect. It is not the task of the marker to rework a candidate's answer to determine how or where errors have arisen. However, for the purpose of this article the error has been identified in the calculation of the fair value of the NCI as the NCI is only 4 million shares.

Note 4
One mark was available and has been awarded for explaining the FV adjustment. (One mark has already been awarded for the amount, in W2.)

Note 5
Only one mark was available for the correcting entry. This is only part of the entry required and is incorrect because the credit should be goodwill (consistent with the candidate's preceding statement). Therefore, no mark is given.

Note 6
One mark was available and has been awarded for explaining the inclusion of contingent consideration. (One mark has already been awarded for the amount, in W3.)

Note 7
One mark has been given for identifying the error in the measurement of NCI. Although the candidate does not explicitly state here that it is an error, this is clearly implied by the reference to the correcting entry that follows. No marks are given for the references to bargain purchase and impairment as this textbook knowledge is not relevant to the case scenario.

Note 8
No mark is given for the accounting entry as it is incorrect. Again, it is not the marker's task, but for the purpose of this article the $1m incorrect debit to reserves is the difference between the contingent consideration ($4m) and the FV adjustment ($5m). If the candidate's only error had been in calculating NCI (see Note 3), they would have been given the mark for a correcting entry consistent with the error under the 'own figure rule' (i.e. as the candidate has already lost the mark for the calculation of NCI, they cannot be penalised again).

Note 9
The candidate did not give sufficient thought to their answer before writing it out. Unnecessary workings (in this case, W2) create unnecessary time pressure. The error in the calculation of NCI may have been careless, but lost the candidate only one mark. The candidate also lost a mark for omitting to consider the 'other side' of the adjustment for the contingent consideration and the mark for the correcting entry (as neither OCI nor reserves were affected). Thinking and planning is an effective use of exam time.

Thinking and planning is an effective use of exam time.

Note 10
Two marks were available and have been awarded for explaining Banana's significant influence over its investment in Strawberry.

Note 11
To earn the other two marks, the candidate needed to explain what constitutes 'equity accounting' and show (i.e. calculate) the 'carrying amount of the investment in Strawberry just prior to disposal'. Read requirements carefully to ensure all constituent parts are answered.

> **Read requirements carefully to ensure all constituent parts are answered.**

Note 12
No mark has been given as *how* the investment should be accounted for (i.e. FVTPL, FVTOCI or amortised cost) has not been specified. The method suggested in the case scenario (FVTOCI) was correct, but had to be justified (see Note 14).

Note 13
One mark is given for including the fair value of the retained interest in the calculation of the gain or loss on disposal. All the candidate then needed to do was deduct the carrying amount of investment which should have been calculated in (a)(ii). Even if the amount in (a)(ii) was incorrect, the candidate would have been awarded the second mark for this calculation, under the 'own figure rule'. However, the candidate appears to have become confused here and the second mark has not been awarded.

Note 14
One mark is awarded for justifying how the investment should be accounted for.

Note 15
One mark is given for the relevant definition and another mark for linking information in the scenario which is relevant to the definition.

Note 16
The conclusion is technically incorrect and the preceding 'discussion' is superficial. However, a mark is given for having drawn a conclusion.

Note 17
These three elements are already defined in IFRS 3. The proposed amendments are to clarify, not rewrite, the definition. One mark is given for illustrating an input using information in the case scenario.

Note 18
One mark is also given for explaining 'process' in the context of Melon.

Note 19
The candidate has already been awarded marks for suggesting that there is no output in justification of their first conclusion (see Notes 15 and 16). So no mark has been given (nor taken away – as there is no negative marking) for now suggesting that there is output.

Note 20
One mark awarded for a revised conclusion – albeit a technically incorrect conclusion.

Note 21
The candidate incorrectly attributed the elements of the definition to the ED rather than IFRS 3 and the conclusions are therefore the 'wrong way round'. (Under IFRS 3 definition, Melon should be treated as a business, but this is less likely under the proposed amendments.) The candidate has not been penalised for this. The case scenario was of course engineered to illustrate why clarification and guidance are needed. The candidate has been rewarded for applying reasonably sound technical knowledge to the case scenario and answering the question set.

Note 22
One mark for outlining the principle of derecognition.

Note 23
One mark for each point applying IFRS 9 derecognition principle to the case scenario.

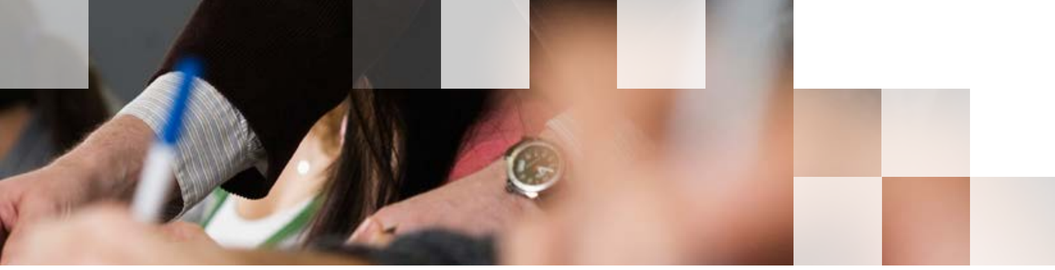
Note 24
One mark for conclusion on accounting treatment.

Note 25
Although the candidate has presented a calculation of amortised cost, it starts with the fair value amount. This is fundamentally wrong as amortised cost prohibits restatement to fair value.

The mark for candidate one for Q1 is 19/30.

TOTAL:

19/30



Notes on candidate two's answer to Q1

Follow this link to see candidate two's answer to Q1

View it here

Note 1
All three marks for the correct calculation of goodwill have been awarded (i.e. one mark for each of the contingent cash consideration, NCI and FV adjustment).

Note 2
No mark has been given as mere repetition of a calculation in words does not contribute to a discussion. The mention of share-based payment is technically incorrect as equity instruments issued in a business combination in exchange for control of the acquiree are 'scoped out' of IFRS 2. However, as there is no negative marking, the candidate has not been penalised for this.

There is no negative marking.

Note 3
No mark has been given as there is no discussion of *why* NCI should be calculated at FV rather than the proportional method. The mark for the calculation has already been awarded (see Note 1) so there is no additional credit for repeating it.

Note 4
Two marks have been awarded – one for explaining *why* the present value should be used and another for expanding on how its subsequent measurement does not affect the goodwill calculation.

Note 5
The calculations are good but explanations are lacking. There is no discussion of the measurement of NCI (see Note 2) and no mention of the FV adjustment. The mark for the accounting entry has been thrown away by failing to give this.

No marks are given for mere restatement of a calculation in words.

Note 6
One mark was available and has given for the calculation of the carrying amount. Again, no marks are given for mere restatement of a calculation in words.

Note 7
As there is no explanation of 'why equity accounting was the appropriate treatment for Strawberry in the consolidated financial statements', this part of the requirement was not answered.

Note 8
To say that something should be 'reflected' in the financial statements does not earn marks at this Strategic Professional level. An accounting treatment must be stated in clear terms (e.g. to answer the questions *How? Where? When?*).

An accounting treatment must be stated in clear terms.

Note 9
Two marks have been awarded for calculating the gain on disposal. Note that full marks would have been awarded even if the carrying amount was incorrect, as long as it was consistent with the carrying amount shown in part (a)(ii).

Note 10
Again, no marks can be given for merely restating a calculation in words.

Note 11
One mark given for identifying the need for an irrecoverable election to support the proposed classification of at FVTOCI.

Note 12
No marks have been awarded for simply summarising the information given in the case scenario.

Note 13
'May be inappropriate' is not a conclusion and, as yet, there is no discussion. So the marker will read on.

Note 14
The proportion of shareholding (all or part) is not a determining factor. For example, a parent that is an investment entity may measure investments in particular subsidiaries at FVTPL in accordance with IFRS 9 instead of consolidating them.

Note 15
Repetition of information given in the scenario earns no marks. Also the candidate is still missing the point that the 'driver' for determining whether the treatment is correct is whether or not Banana has acquired a business. Considering the implications of the treatments is a digression and the distinction between research and development is irrelevant (as currently there are only research activities).

Note 16
At this point the candidate seems to have realised that the question might have something to do with the definition of a business. Unfortunately, it is not true that this is not defined in IFRS 3. Also, since IFRS 3 makes no reference to 'legal entity' it is not clear what the candidate is trying to suggest here. Perhaps they meant to suggest that IFRS 3 distinguishes between the acquisition of a business and a purchase of a group of assets – but this is not what has been written.

Note 17
Again, it is not clear what point the candidate is trying to make. The ED proposed amendments to the definition of a business to help reporting entities distinguish between a business and a group of assets when applying IFRS 3. It does not concern any principles of asset recognition. The conclusion is incorrect.

Note 18
The candidate clearly lacks technical knowledge and understanding of a current issue that is fundamental to accounting for business combinations.

Note 19
The question asked for a discussion of *derecognition* requirements in respect of the 'sale' on 1 July 20X6. These comments concerning classification on initial recognition of the bonds acquired are irrelevant.

Note 20
Only two marks were available for calculations – 1 mark each for the carrying amount of the bond on 1 July 20X6 and 30 June 20X7. Both marks have been given.

Note 21
Credit has been given for a conclusion, even though there is no discussion of IFRS 9 principles.

Note 22
The journal is clearly incorrect as the financial liability is only $8 million (initially) and unrelated to the carrying amount of the financial asset.

Note 23
This is repetition.

The mark for candidate two for Q1 is 12/30.

TOTAL:

12/30

Question 2

Question 2 will involve the consideration of the reporting and ethical implications of some accounting issues presented in a specific scenario. Ethics will feature in every exam, and it is essential that candidates *demonstrate* their understanding of the implications of these ethical issues. Two professional marks will be awarded to this question and these marks relate to the quality of the discussion.

Ethics will feature in every exam.

Required:

(a) Discuss the accounting treatment which Farham should adopt to address each of the issues above for the consolidated financial statements.

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

(b) Discuss the ethical issues arising from the scenario, including any actions which Farham and the accountant should undertake. **(7 marks)**

Professional marks will be awarded in Question 2 for the quality of the discussion. **(2 marks)**

(20 marks)

Application of knowledge is required throughout.

Observations on the requirement

A good approach to answering this style of question is provided in the ACCA article **Exam techniques for success** (page 4):

- **Read** the scenario to **identify** the two 'situations' and the accounting issues:
  - Factory subsidence (5 marks):
    Future major repairs (cost uninsured).
    No disclosure. No allowance for impairment.
    No provision. Proposed use of revaluation surplus.
  - Planned sale of a subsidiary (6 marks):
    Held for sale. Restructuring provision including future trading losses.
- **Think** about the suggested accounting treatment(s) bearing in mind the inappropriate behaviour of the chief operating officer (COO) that is indicated throughout the scenario.
- **Plan** the points to be made to avoid repetition and making irrelevant points. The ethical issues raised by the COO's behaviour must be discussed in part (b).
- **Write** your answer under clear headings for each 'situation'.

Part (b) called for ethical issues 'arising from the scenario'. Application of knowledge is required throughout.

For the professional marks, the answer is considered as a whole in the light of whether the candidate demonstrated:

- An understanding of the reality of a problem.
- Wider consideration of other resources/implications where relevant and sensible to do so.
- A depth of understanding what needs to be done to resolve the situation (as prompted by the requirement to include 'any actions which Farham and the accountant should undertake').

Notes on candidate one's answer to Q2

Follow this link to see candidate one's answer to Q2

View it here

Note 1
Background information introduces the case scenario and provides context for the issues that follow. It should be read carefully for hints of things to look out for. For example, a 'profit related bonus scheme' should prompt the idea of possible management bias in overstating profits (e.g. through understating liabilities). This should be borne in mind when planning an answer. The background paragraph was not one of the two issues and it was a waste of time to try and address it as such. The bonus scheme itself was not an issue and its form (share based or otherwise) a matter of speculation. No marks can be awarded as this does not answer the question set.

Note 2
There are no marks for merely restating information given in the scenario.

There are no marks for merely restating information given in the scenario.

Note 3
No marks have been awarded. The stated features of a contingent liability are incorrect. Although it is true that it is not a provision it is not because it cannot be measured but because there is no liability (because there is no obligation).

Note 4
The first sentence restates the information in the scenario adding only the words 'which is misleading'. As a marker cannot guess the candidate's meaning in the absence of any explanation, this earns no mark. One mark has been given for recognising that there is impairment, even though it is the carrying amount of the production facility that should be tested and not the repair costs (which would be expensed).

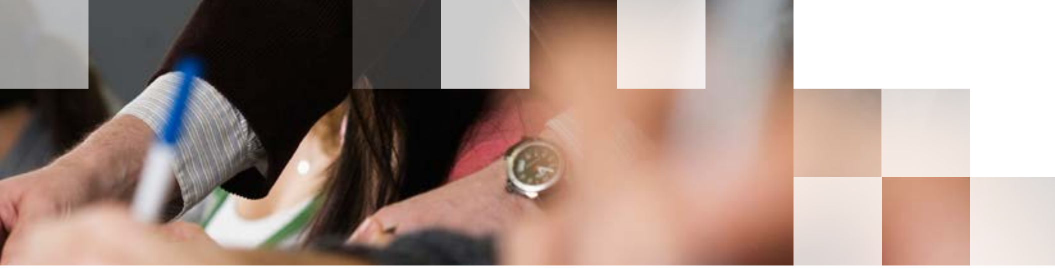
Note 5
There are no marks for stating textbook knowledge without any application to the scenario.

Note 6
No marks for what is effectively repetition of the previous point.

Note 7
The first sentence is irrelevant. One mark has been given for giving a reason why using the revaluation would be appropriate. Although the correct authority for this is IAS 16, the candidate has not been penalised for referencing the Conceptual Framework.

Note 8
One mark has been awarded for applying the information in the scenario to the held for sale criteria and another mark for correctly concluding that criteria have been met. No mark has been given for the amount of the restructuring provision as this is incorrect. The provision should have been $13 million ($2m legal + $5m redundancy + $6m penalty).

Note 9
This is incorrect. The only part of the future trading losses that should have been included is the $6 million early payment penalty for a leased asset.



Note 10
One mark has been given for each of these three relevant comments.

Note 11
One mark is given for the suitable action of explaining a relevant matter to the COO. No mark is given for the second sentence as why the accountant may be uncertain (or what the uncertainty could be about) is unclear and 'refer to advice' is too general.

Note 12
This entire paragraph restates the scenario. There is no discussion of the underlying ethical issues.

Note 13
Credit has already been given for stating that the accountant should act professionally (see Note 10). One mark has been given for suggesting the generic action of obtaining professional/legal advice. However, to consider resigning at this point is premature.

Note 14
No credit has been given as again this has been copied from the question.

Note 15
This repeats the second sentence of the answer, for which a mark has already been awarded, so no further credit can be given.

Note 16
The candidate may have been looking for an action which the directors rather than the accountant should undertake. However, the suggestion is too vague. (To whom would they report? And to what end?)

Note 17
Although the candidate has made some relevant points, for which due credit has been given, there is no real discussion. The candidate has repeated a lot of information from the scenario rather than draw together the different 'strands' of the information to demonstrate an understanding of the ethical principles and issues. The questionable competence of the accountant has been completely overlooked. No professional skills marks have therefore been awarded.

The mark for candidate one for Q2 is 9/20.

TOTAL:

9/20

Notes on candidate two's answer to Q2

Follow this link to see candidate two's answer to Q2

View it here

Note 1
There are no marks for stating textbook knowledge without any application to the scenario.

Note 2
There are no marks for incorrect application of knowledge. Provisions cannot be made for future repairs as there is no obligation.

Note 3
No marks for incorrect conclusion or repetition of textbook knowledge.

Note 4
One mark given for recognising impairment in the production facility. For further marks the candidate needed to elaborate on identifying a suitable cash generating unit and how relevant measures (fair value and value in use) could be determined.

Note 5
One mark was available and has been awarded for concluding that as the revaluation surplus cannot be used for the loss arising in respect of the production facility.

Note 6
Again there are no marks for stating knowledge, so it is a waste of time to copy it out in this manner.

Note 7
No marks for merely restating the information given in the scenario.

Note 8
One mark is given for applying the criteria and one mark for the correct conclusion. Note that this could have been stated far more succinctly with less detail copied from the scenario.

Note 9
Provision cannot be made for future trading losses, so no mark for this incorrect statement.

Note 10
One mark is awarded for recognising that provision should be made for the legal costs. The double entry is incorrect but as there is no negative marking the candidate cannot be penalised for this.

There are no marks for stating textbook knowledge without any application to the scenario.

Note 11
No mark for an incorrect conclusion drawn on an assumption which contradicts the information in the scenario. The scenario clearly described the redundancy costs as an expected cost from the sale.

Note 12
Two marks have been awarded for explaining why the COO's behaviour is unethical in the context of responsibility for the financial statements.

Note 13
Two marks have been awarded; one for each suitable action.

Note 14
The candidate could have been more explicit about how the accountant may act unethically but one mark is given for referring to professional and legal advice.

Note 15
Although this point did not feature in the published answer it is a relevant action which Farham could undertake and is therefore awarded one mark.

Note 16
Although the competence of the accountant as an ethical issue has again been overlooked, the candidate has attempted a discussion of the COO's behaviour which identifies a self-interest threat. The candidate has suggested a sensible response from the accountant before taking legal advice. The last point demonstrates insight into the crux of the problem – namely the current profit-related bonus scheme. This short answer therefore earns both of the available professional marks.

The mark for candidate two for Q2 is 11/20.

TOTAL:

11/20

September 2018 exam marked answers

Marks

Notes

Question 1 – Candidate one

(a)(i)

W1. GROUP STRUCTURE

Banana → Grape (80%)

Acquisition date 1/Jan/X7, so 6 months ago

0 ← Note 1

W2. NET ASSETS OF GRAPE

NET ASSETS	@ ACQUISITION ($M)	@ REPORTING DATE ($M)	DIFFERENCE ($M)
Equity share capital	20	20	0
Retained earnings	42		
Other components of equity	8		
Fair value uplift of land	5	5	
Total net assets	75		

1 ← Note 2

W3. GOODWILL

Consideration:	Calculation	Amount $m
Share consideration	10m * 6.80	68
Contingent consideration	16m * 0.25	4
Fair value of NCI at acquisition	10m * 4.25	42.5
Less net assets at acquisition		75
Goodwill		39.5

1 ← Note 3

The fair value uplift of land should have been included when calculating the net assets of Grape at acquisition, as the value of the subsidiary's assets should be revalued to fair value at the acquisition date, in order to give information which is relevant and faithfully represents the value of the subsidiary at acquisition.

1 ← Note 4

Also, not including the land fair value uplift incorrectly increases the value of goodwill in the statement of financial position.

The journal corrections for this would be to:

Debit Non-current assets $5m

Credit OCI $5m

0 ← Note 5

Relevant notes

Marks

Notes

The contingent consideration should still be included in the calculation of goodwill, as it is part of the total consideration. However, it would be multiplied by the probability of its occurrence to give the expected value figure. **1** ← Note 6

Using the proportional method for calculating the NCI instead of the fair value method reduces the value of goodwill, as can be seen above, and potentially increases the probability of a bargain purchase. This also means that any impairment of goodwill goes only to Banana, not to the NCI. **1** ← Note 7

To correct this error therefore, the FD would need to:

Debit Goodwill (39.5 – 12) = $27.5m

Credit NCI (42.5 – 14) = $28.5m **0** ← Note 8

Debit equity reserves $1m

TOTAL – Part (a)(i): 5/8 ← Note 9

(ii)

Equity accounting is used when accounting for an associate. With an associate, the parent has significant influence, but not control, over the entity. This is assumed the case when 29%-50% of shares in the associate (Strawberry) is held by the parent (Banana), unless there are other factors mitigating this. In this case, Bana owns 40%, so that points to significant influence. **2** ← Note 10

Furthermore, Banana has the right to appoint 1 out of 5 directors, which also points to significant influence.

TOTAL – Part (a)(ii): 2/4 ← Note 11

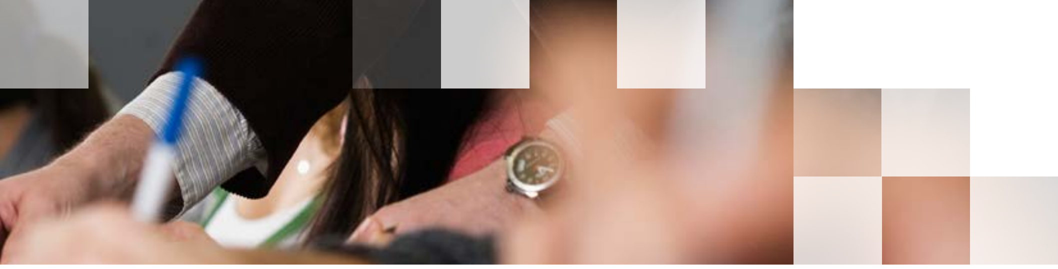
(iii)

Following the sale of its shares and loss of significant influence it will now account for Strawberry as a financial asset. Therefore equity accounting will no longer apply and it will simply be recorded among other financial assets in the non-current assets of the SOFP. **0** ← Note 12

	$m
Proceeds of disposal	19
FV of retained interest	4.5
	23.5
Less: FV of net assets at disposal date	50
Goodwill at date of disposal	
Less FV of NCI at disposal	

1 ← Note 13

Relevant notes



Marks

Notes

Goodwill

	$m
FV of consideration paid	18
Fair value of NCI at acquisition	
Less net assets at acquisition	44
Goodwill	

0 ← Note 13

As they do not wish to hold their remaining shares for trading purposes, they can classify the investment as FV through other comprehensive income.

1 ← Note 14

TOTAL – Part (a)(iii): 2/4

(b)

According to IFRS 3 Business Combinations a business is an integrated set of activities capable to generate return to its owners in terms of dividends, lower costs or other economic benefits. Melon has only one asset which is a licence, does not have any employees and it is not clear if there will be inflow of economic benefits from research activities or not (as the stage or research is very early).

2 ← Note 15

So Melon should be accounted for as a financial asset acquisition as this contradicts the IASB's current definition of a business.

1 ← Note 16

The Exposure Draft defines a business as consisting of three components which are input, processes and output. Input relates to the materials used by an entity for producing the final results. In the case of Melon, it has a licence to carry out research activities, it has personnel provide by the management company, which are its input.

1 ← Note 17

As for process, Melon has outsourced its research activities to the management company and the management company supply personnel to provide supervisory activities and administrative functions. These are processes as they are the ways to achieve the goal and produce the 'output'.

1 ← Note 18

Output relates to the final products of an entity. In the case of Melon, it operates in the biotechnology industry and uses the input and processes discussed above to produce the biotechnology product, otherwise, it may not be existing in this industry.

0 ← Note 19

So the IASB's proposed amendments would revise my conclusion. Melon is a business, rather than just a financial asset acquisition and it should apply IFRS 3.

1 ← Note 20

TOTAL – Part (b): 6/7

← Note 21

Relevant notes

Marks

Notes

(c)

There is a sale when the seller loses substantially the rights and obligations relating to the financial asset, the right to variable returns, the risks of the asset, and so is not affected by subsequent changes in the value of the instrument. **1** ← Note 22

A sale is likely if the transaction price is set at fair value/market value. In this case, the bonds were sold to the third party for $2.5m less than their fair value. **1** ← Note 23

Banana will compensate the third party for any devaluation of the bonds and the third party is obliged to return coupon interest to Banana. Therefore Banana retains the risks and rewards of ownership. **1** ← Note 23

Therefore, the transaction should be recorded as a loan rather than a sale. Banana should therefore not derecognise the asset. **1** ← Note 24

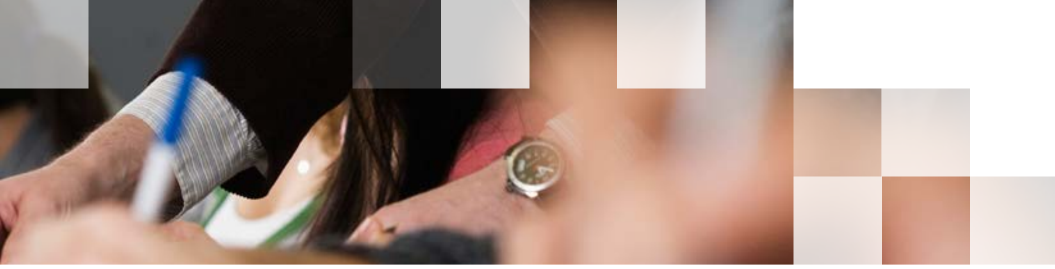
Date	Start ($m)	Interest (7%)	Cash paid (5%*10m)	End
($m)				
30.6.x7	10.5	0.735	–0.5	10.735
30.6.x8	10.735	0.751	–0.5	10.99

0 ← Note 25

TOTAL – Part (c): 4/7

TOTAL Q1: 19/30

Relevant notes



Marks

Notes

Question 1 – Candidate two

(a)

(i) Goodwill calculation

$B \xrightarrow{80\%} G$

Consideration transferred:	share = 10 x 1 x 6.8 = 68	
	cash = 16 x 25% = 4	
NCI	4.75 x 20 = 85 x 0.2 = 17	
– FV of net identifiable assets	(75)	
SC	20	
RE	42	
OCE	8	
FV adj – land	5	
Goodwill	14	**3** ← Note 1

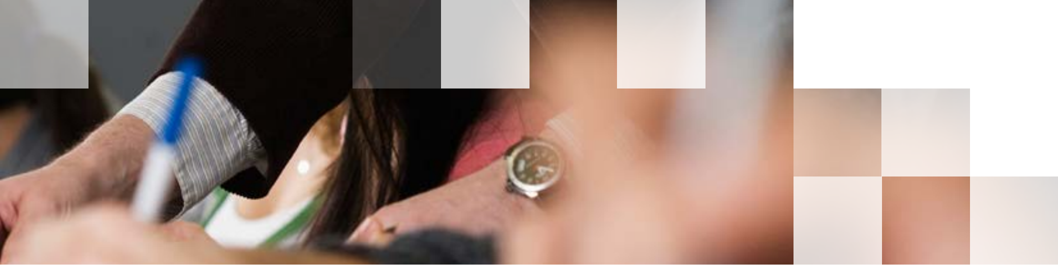
The consideration transferred comprises the cash and share-based payment. As to the share-based payment, it is calculated by share price multiply by share number. **0** ← Note 2

NCI should be included. NCI is equal to the share price multiply by share number in the proportion of 20% of NCI: 4.25 x 20 x 20% = 17. **0** ← Note 3

In addition, 18 of cash consideration should not be used due to its date 1 January 2019. The present value at acquisition date, 16 million should be used. This part consideration would then be unwound in 20X9 and recognised in profit or loss. It doesn't affect goodwill calculation. **2** ← Note 4

TOTAL – Part (a)(i): 5/8 ← Note 5

Relevant notes



Marks

Notes

(a)(ii)

Carrying amount of the investment in Strawberry on the date of disposal should include the cost to purchase the shares and any reserves after the date of purchase that belongs to Banana:

Purchase price	$18m
(+) Post acqn reserves	$2.4m
($80m – $44m) x 40%	
Carrying amount	$20.4m

1 ← Note 6

TOTAL – Part (a)(ii): **1/4** ← Note 7

(a)(iii)

As Banana no longer holds 40% in Strawberry it should reflect this in its consolidated financial statements. Therefore, the sale of 30% of shareholding should be reflected as:

0 ← Note 8

Proceeds	$19m	
FV of investment retained	$4.5m	
(–) Carrying amount of investment	($20.4m)	per (ii)
Gain on disposal	$3.1m	

2 ← Note 9

The gain on disposal of $3.1 should be calculated by comparing the 40% shareholding as per Banana's financial statement on the date of disposal and the proceeds received for sale of 30% of shareholding and FC of the 10% shareholding retained.

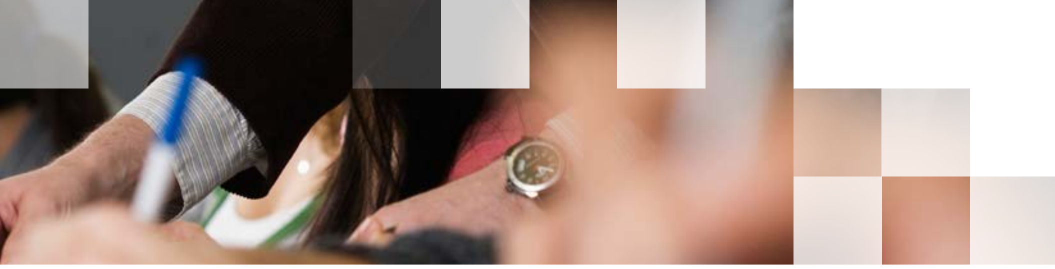
0 ← Note 10

The remaining 10% of shareholding is now classed as a financial asset. It should be measured at FV on recognition and as Banana has made an irrevocable election to measure this through OCI, it should be measured at every year end with any difference put through OCI.

1 ← Note 11

TOTAL – Part (a)(iii): **3/4**

Relevant notes



Marks

Notes

(b)

On 30 June 20X7, Banana acquired 100% equity interest in Melon and the directors want to treat Melon as a financial asset acquisition since as at 30 June 20X7, it does not have employees, nor carries out any of its own processes and has only a licence to carry out research activities as asset.

0 ← Note 12

It may be inappropriate for directors to treat Melon as a financial asset recognition.

0 ← Note 13

Firstly, Banana acquired all of the shares of Melon. If Melon is recognised as financial asset, under IFRS 9, Banana should acquire part of share of Melon rather than all. And therefore Melon should be recognised as a subsidiary rather than financial asset.

0 ← Note 14

Secondly, Melon was recently formed and the only asset consists of license to carry out research activities. This company, Melon, is involved in R&D research. If recognised as a separate entity, when consolidated the research part will be recognised as expense in profit or loss and the development part which are passed appraisal will be capitalised. This appraisal includes whether the product can be used, technically feasible and bringing future economic benefit with reliable amount. But now these research and development activities are still at a very early stage and it is not clear that any definitive product would result from the activities. If in consolidation all these will be recognised as expense and reduce the whole profit. If recognised in financial asset, all the expenses will not be shown. The decrease or increase of financial asset is easy to manipulate due to lack of details disclosed.

0 ← Note 15

Unfortunately, IFRS Business Combination currently doesn't define a business. However it does state that if an entity purchases another legal entity, then it should account for it as an investment in that entity. But if it is not a separate legal entity then it should treat it as a purchase of assets. This is also known as a joint operation.

0 ← Note 16

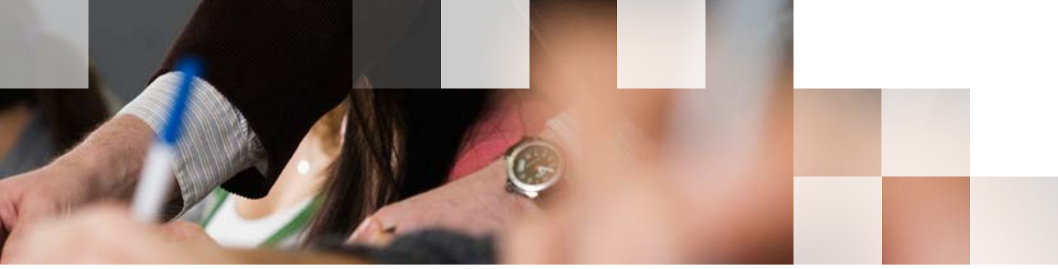
Under International Accounting Standard Board's proposed amendments to the definition of a business, if a business items item wants to be recognised as a an asset, it must be controlled by the entity and produce economic benefits from past events. Neither requirements are met. Therefore, as per IASB's proposed amendment draft, Melon would not be classed as a business.

0 ← Note 17

TOTAL – Part (b): 0/7

← Note 18

Relevant notes



Marks

Notes

(c)

According to IFRS 9 Financial Instruments:

– If the debt has only to be held, the debt is measured by amortised cost model. The initial measurement is the fair value plus the transaction cost and the subsequent measurement uses amortised cost model. **0** ← Note 19

– If the debt can be sold, the debt should be measured at fair value through other comprehensive income. The change in fair value of the debt is recognised in OCI and it will be remeasured to profit or loss when disposed.

1.7.20X5 10m interest rate 5% Effective rate = 7%

At initial measurement: no transaction price and therefore:

1.7.20X5	10
+ Effective interest income (10 x 7%)	0.7
– Coupon received	(0.5)
1.7.20X6	10.2

1 ← Note 20

On 1.7.20X7 Banana sold the bond to a third party for $8m but the bond at carrying value is $10.2m and the fair value is $10.5m. After that, Banana has the right to purchase the bond back at $8.8m. Therefore it's like a financing activity and loan should be recognised. **1** ← Note 21

1.7.20X6	10.2
+ Effective interest income (10.2 x 7%)	0.714
– Coupon received	(0.5)
1.7.20X7	10.414

1 ← Note 20

Therefore: 1.7.20X6

	DR	CR
Loan liability		10.2
Cash	8	
Retained earnings	2.2	

0 ← Note 22

Loan arising from financing – bond increase 10.2
Cash current asset: 8 (increase) **0** ← Note 23

TOTAL – Part (c): **3/7**

TOTAL Q1: **12/30**

Relevant notes

September 2018 exam marked answers

Question 2 – Candidate one

Marks

Notes

(a)

Background

Farham was offering performance based payment to its employees which indicates that share base payment was offered to employees.

But the company performance was so poor so Farham decided to sell its subsidiary due to huge loss making.

0 ← Note 1

Factory subsidence

Farham has a production facility which started to show signs of subsidence since January 2018.

0 ← Note 2

It is a contingent liability because:

(i) it is because of the past event

(ii) it is probable

(iii) it is uncertain whether it will correct the problem.

Although it does not meet the definition of provision under IAS 37 since it is difficult to measure it reliably which means it does not need to be presented as a provision in the statement of financial position.

0 ← Note 3

It is obvious that it is a contingent liability and should be disclosed in accordance with IAS 37 in the note explaining its nature.

(2) Impairment loss

The COO does not think the subsidence is an indicator of impairment because there is no legal or constructive obligation which is misleading. However the repairs costings will need to be tested for impairment, as damaged to PPE are indicators of impairment according to IAS 36.

1 ← Note 4

Impairment tests should be carried out at the end of each reporting period. The test which is carried out is where the carrying amount is compared to the recoverable amount.

0 ← Note 5

Farham should take regular impairment testings especially when indicators arise. Farham should undertake the test consistently and at each reporting end.

0 ← Note 6

Relevant notes

Marks | Notes

(3) Revaluation surplus

The revaluation surplus should be accounted for through OCI. It is not proper to use for any future loss from the subsidence of the production facility because the revaluation of the PPE is not matched with the subsidence and is not in accordance with the Conceptual Framework. **1** ← *Note 7*

Sale of Newal

(i) Restructure

At 30 June 20X8 Farham had a plan to sell its 80% subsidiary Newall. **0** ← *Note 2*

The plan of restructure should be recognised because:

(i) The plan has been approved by the board

(ii) Oldcastle will be the expected buyer

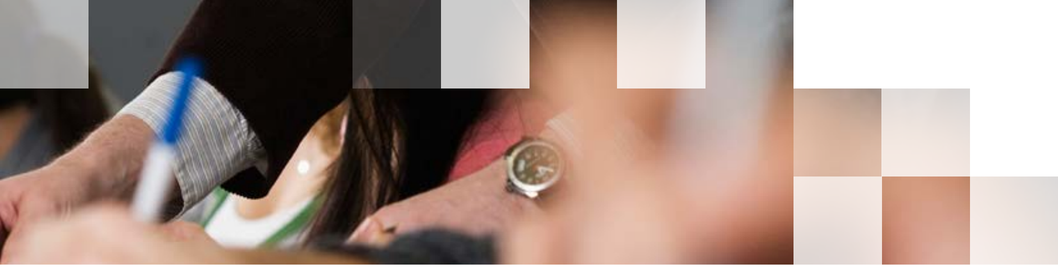
(iii) The sale is expected to be completed by December 20X8, which is within one year. **2** ← *Note 8*

Therefore the subsidiary should be recognised as held for sale and the restructuring provision as \$29m (30 – 6 + 5). **0** ← *Note 8*

The early payment penalty should not be recognised in future trading losses as all the liability attached to the asset will be transferred to Oldcastle. **0** ← *Note 9*

TOTAL – Part (a): 4/11

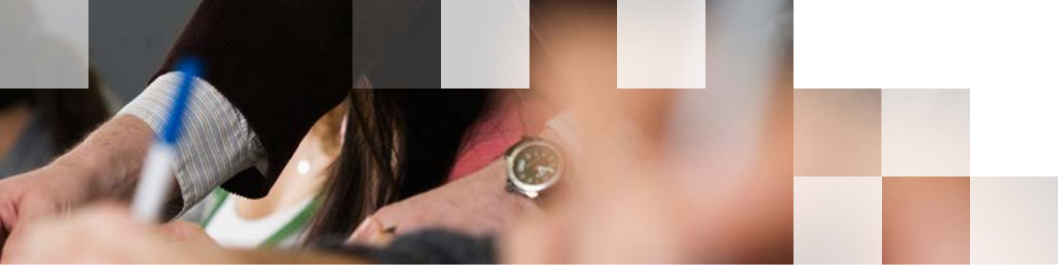
Relevant notes



(b)	Marks	Notes
(i) COO refuses to disclose the issue of subsidence even though she is aware that this is contrary to IAS.	0	Note 2
This is breach of ethical principle of integrity.	1	Note 10
Directors have the responsibility to prepare the financial statements in accordance with IFRS.	1	Note 10
Accountant should remain professional and discuss the matter with others affected by the non-disclosure in the company, such as other directors.	1	Note 10
(ii) Revaluation The accountant should explain why the revaluation surplus cannot be used for any future loss to the COO. If the accountant is uncertain he can refer to the advices from professional such as ACCA.	1	Note 11
(iii) COO does not wish Newall to be disclosed as held for sale nor to provide for the expected loss. COO is concerned that it will affect the sales price and would almost certainly mean bonus target would not be met. The COO threatens the accountant may lose his job if he were to put such provision.	0	Note 12
The accountant should act professionally and not be influenced by any undue pressure. Profession (ACCA) and legal advice could be taken if it is necessary. And also resignation should be considered if it is necessary.	1	Note 13
(iv) COO argued that they have a duty to secure high sale priced to maximise the return of shareholders.	0	Note 14
Directors should be responsible to the shareholders by presenting true and fair information rather than manipulated financial statements.	0	Note 15
The directors of Farham should report the behaviour of this COO as this is unacceptable.	0	Note 16
TOTAL – Part (b):	**5/7**	
Professional marks	0	Note 17

TOTAL Q2: 9/20

Relevant notes



Think Ahead

Marks

Notes

Question 2 – Candidate two

(a)

Factory subsidence

Under IAS 37 provisions, its defined as a upcoming liability/cost which is going to occur. The provision should be made at a best estimate and measured at fair value. A provision is only made when the following criteria is met: if it is probable, if it can be measured reliability and if there is a present obligation. The present obligation can be legal or constructive.

0 ← Note 1

The provision that Farham has is the major repairs that are going to happen in 20X9 to correct a problem. The obligation is there and its classed as constructive. The repairs are probable as stated by Farham as they will go ahead. In which case they are able to be measured reliably.

0 ← Note 2

Farham needs to recognise the provision in the financial statements so they are complying with IAS 37. The provision Farham will recognise will be at fair value and the best estimate.

0 ← Note 3

IAS 36 Impairment of assets says that an impairment test should be undertaken where there is an indicator both external and internal. The sign of subsidence gives an internal indicator that the production facility has been obsolete or partially damaged, The company requires to undertake impairment test to find where there is an impairment in facility.

1 ← Note 4

IAS 16 Property plant and equipment allows entity to undertake revaluation model on assets. An asset that has been revalued can reduce its value to the extent of the surplus. However, none of the revaluation balance relates to the production facility. Therefore, the surplus should not be used for the facility's loss.

1 ← Note 5

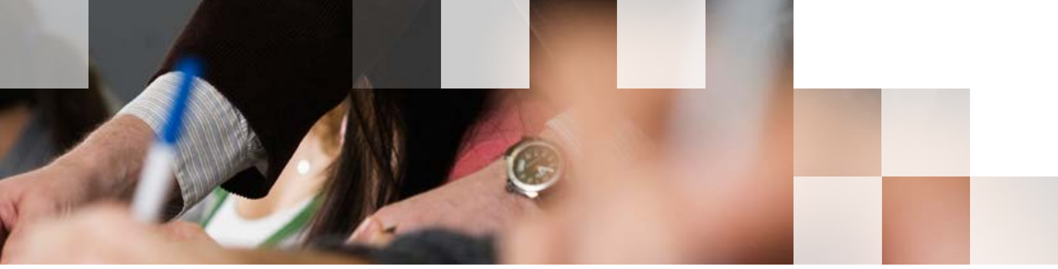
Sale of Newall

Under IFRS 5 NCA held for sale, an asset can be classed as held for sale if the entity wishes to sell the asset instead of using it within the business certain criteria must be met in order to classify as held for sale. The criteria that must be met is as follows:

- Must be seeking a buyer
- Must be available for immediate sale
- Must be probably economic benefit
- Must be expected to sell within a year (1 year).

0 ← Note 6

Relevant notes



Marks

Notes

Farham is planning to sell 80% subsidiary in Newall. This has been approved by the board and reported in the media. The accountant wishes to show Newall in the accounts as held for sale.

0 ← Note 7

Farham is seeking a buyer for the sale of Newall as it is expected that Oldcastle will acquire the extra 80% holdings as they own 20% already. Farham states that the sale is available for immediate sale as the plan has been approved by the board. Farham's sale is probable as it is highly likely it will happen. Farham's sale is expected within a year as the sale is expected to be completed by December 20X8 and the plan arose at 30 June 20X8. So that shows that its expected in a 1 year period. Farham should recognise Newall as NCA held for sale because all the criteria is met according to IFRS 5.

2 ← Note 8

The provision for the trading losses needs to be made as the obligation is there and in accordance with IAS 37.

0 ← Note 9

Farham needs to provide for the legal costs of sale. Therefore the correct accounting for this would be:

1 ← Note 10

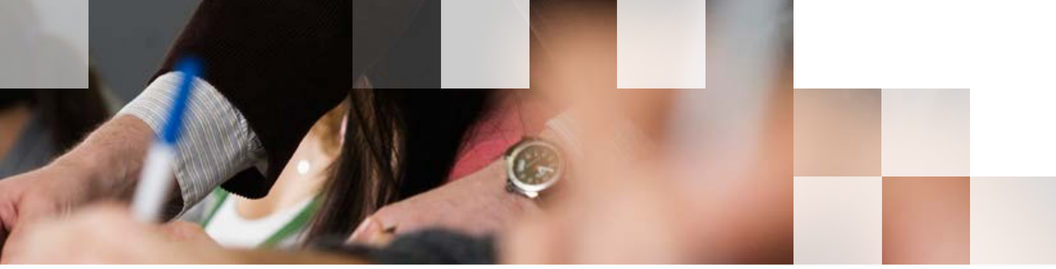
Dr Provision $2m
Cr PPE $2m

The redundancy costs for Newall employees should not be provided for as no information is telling that employees will lose or keep their job. Therefore no provision should be made as a reliable obligation is not present.

0 ← Note 11

TOTAL – Part (a):
5/11

Relevant notes



Marks | Notes

(b)

In the sale of Newall, the COO is concerned as to how this may affect the sales price and would almost certainly mean bonus targets would not be met. There is a self-interest threat – because of the bonus the COO will not provide for the expected losses. However, the responsibility of the board of directors to provide true and fair financial statements to help users make economic decision is more important. **2** ← Note 12

Besides the accountant also implied that he may lose his job if he were to put such provision in the financial statement. The accountant should explain to the COO how it meets the criteria and disclosure requirements. If the COO still refuses to prepare the financial statements in accordance with IFRS, the accountant should have a conversation with someone else like a director or other key management personnel. **2** ← Note 13

The accountant under pressure from the COO may act unethically. So the accountant has the right to use the ACCA's ethical Code and take legal advice. **1** ← Note 14

Farham should revise the bonus scheme based on more long-term performance. **1** ← Note 15

TOTAL – Part (b): 6/7

Professional marks **2** ← Note 16

TOTAL Q2: 14/20

For more tutor resources, visit **accaglobal.com/educationhub**

For more student resources, visit **accaglobal.com/exam-resources**