Answers

1 **(a)** **Explanatory note to: The directors of Moyes**
Subject: Cash flows generated from operations

(i)

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Profit before tax	209
Share of profit of associate	(67)
Service cost component	24
Contributions into the pension scheme	(15)
Impairment of goodwill	10
Depreciation	99
Impairment of property, plant and equipment ($43m – $20m)	23
Movement on inventory ($165m – $126m – $6m)	33
Loss on inventory	6
Increase in receivables	(7)
Increase in current liabilities	18
Cash generated from operations	333

(ii) Cash flows from operating activities are principally derived from the key trading activities of the entity. This would include cash receipts from the sale of goods, cash payments to suppliers and cash payments on behalf of employees. The indirect method adjusts profit or loss for the effects of transactions of a non-cash nature, any deferrals or accruals from past or future operating cash receipts or payments and any items of income or expense associated with investing or financing cash flows.

The share of profit of associate is an item of income associated with investing activities and so has been deducted. Likewise cash paid to acquire property, plant and equipment is an investing cash flow rather than an operating one. Non-cash flows which have reduced profit and must subsequently be added back include the service cost component, depreciation, exchange losses and impairments. With the impairment of property, plant and equipment, the first $20 million of impairment will be allocated to the revaluation surplus so only $23 million would have reduced operating profits and should be added back. In relation to the pension scheme, the remeasurement component can be ignored as it is neither a cash flow nor an expense to operating profits. Cash contributions should be deducted, though, as these represent an operating cash payment ultimately to be received by Moyes' employees. Benefits paid are a cash outflow for the pension scheme rather than Moyes and so should be ignored.

The movements on receivables, payables and inventory are adjusted so that the timing differences between when cash is paid or received and when the items are accrued in the financial statements are accounted for. Inventory is measured at the lower of cost and net realisable value. The inventory has suffered an overall loss of $6 million (Dinar 80 million/5 – Dinar 60 million/6). Of this, $2·7 million is an exchange loss (Dinar 80 million/5 – Dinar 80 million/6) and $3·3 million is an impairment (Dinar (80 – 60) million/6). Neither of these are cash flows and would be added back to profits in the reconciliation. However, the loss of $6 million should also be adjusted in the movement of the inventory as a non-cash flow. The net effect on the statement of cash flows will be nil.

(b) When the parent company acquires or sells a subsidiary during the financial year, cash flows arising from the acquisition or disposal are presented within investing activities. In relation to Davenport, no cash consideration has been paid during the current year since the consideration consisted of a share for share exchange and some deferred cash. The deferred cash would be presented as a negative cash flow within investing activities but only when paid in two years' time.

This does not mean that there would be no impact on the current year's statement of cash flows. On gaining control, Moyes would consolidate 100% of the assets and liabilities of Davenport which would presumably include some cash or cash equivalents at the date of acquisition. These would be presented as a cash inflow at the date of acquisition net of any overdrafts held at acquisition. Adjustments would also need to be made to the opening balances of assets and liabilities by adding the fair values of the identifiable net assets at acquisition to the respective balances. This would be necessary to ensure that only the cash flow effects are reported in the consolidated statement of cash flows. Fair value adjustments to assets and liabilities could also have deferred tax effects which would need adjusting so that only cash payments for tax are included within the statement of cash flows. Dividends received by Moyes from Davenport are not included in the consolidated statement of cash flows since cash has in effect been transferred from one group member to another. The non-controlling interest's share of the dividend would be presented as a cash outflow in financing activities.

On the disposal of Barham, the net assets at disposal, including goodwill, are removed from the consolidated financial statements. Since Barham is overdrawn, this will have a positive cash flow effect for the group. The overdraft will be added to the proceeds (less any cash and cash equivalents at disposal) to give an overall inflow presented in investing activities. Care would once again be necessary to ensure that all balances at the disposal date are removed from the corresponding assets and liabilities so that only cash flows are recorded within the consolidated statement of cash flows.

(c) IFRS® 5 *Non-current Assets Held for Sale and Discontinued Operations* defines a discontinued operation as a component of an entity which either has been disposed of or is classified as held for sale, and

(i) represents a separate major line of business or geographical area of operations;

(ii) is a single co-ordinated plan to dispose of a separate major line or area of operations;
(iii) is a subsidiary acquired exclusively for resale.

Both entities would be components of the Moyes group since their operations and cash flows are clearly distinguishable for reporting purposes. Barham has been sold during the year but there appears to be other subsidiaries which operate in similar geographical regions and produce similar products. Little guidance is given as to what would constitute a separate major line of business or geographical area of operations. The definition is subjective and the directors should consider factors such as materiality and relevance before determining whether Barham should be presented as discontinued or not.

To be classified as held for sale, a sale has to be highly probable and the entity should be available for sale in its present condition. At face value, Watson would not appear to meet this definition as no sales transaction is to take place.

IFRS 5 does not explicitly extend the requirements for held for sale to situations where control is lost. However, the International Accounting Standards Board (the Board) have confirmed that in instances where control is lost, the subsidiaries' assets and liabilities should be derecognised. Loss of control is a significant economic event and fundamentally changes the investor–investee relationship. Therefore situations where the parent is committed to lose control should trigger a reclassification as held for sale. Whether this should be extended to situations where control is lost to other causes would be judgemental. It is possible therefore that Watson should be classified as held for sale but to be classified as a discontinued operation, Watson would need to represent a separate major line of business or geographical area of operation.

(d) Different accounting standards use different levels of probabilities to discuss when assets and liabilities should be recognised in the financial statements. For example, economic benefits from property, plant and equipment and intangible assets need to be probable to be recognised; to be classified as held for sale, the sale has to be highly probable. Under IAS® 37 *Provisions, Contingent Liabilities and Contingent Assets*, a provision should be probable to be recognised. Uncertain assets on the other hand would have to be virtually certain. This could lead to a situation where two sides of the same court case have two different accounting treatments despite the likelihood of payout being identical for both parties. Contingent consideration is recognised in the financial statements regardless of the level of probability. Rather the fair value is adjusted to reflect the level of uncertainty of the contingent consideration.

The Board has confirmed a new approach to recognition criteria which requires decisions to be made with reference to the qualitative characteristics of financial information. An entity should now recognise an asset or liability if such recognition provides users of financial statements with:

– more relevant information and faithful representation of the asset or liability;
– information which results in benefits exceeding the costs of the information.

A key change here is to remove the probability criterion. This means that more assets and liabilities with a low probability of inflow or outflow of economic resources are likely to be recognised. The Board accepts that prudence could still mean there will be inconsistencies in the recognition of assets and liabilities within financial reporting standards but may be a necessary consequence of providing the most useful information.

2 (a) The Halam property should not have been classified as an investment property because it is a finance lease as the lease term is equal to the useful life and its residual value is deemed to be minimal. Edingley should record a right to use asset and Fiskerton should derecognise the property. Fiskerton should instead record a lease receivable equal to the net investment in the lease. The property needs to be removed from investment properties and the fair value gains of $8 million reversed. In any case, the fair value gains were incorrectly calculated since adjustments should have been made for the differences between the Halam building and the one sold due to the different location and quality of the materials between the two buildings. It would appear that $22 million would have been a more accurate reflection of fair value.

The incorrect treatment has enabled Fiskerton to remain within its debt covenant limits. Gearing per the financial extracts is currently around 49·8% (50/(10 + 20·151 + 70·253)). Fair value gains on investment properties are reported within profit or loss. Retained earnings would consequently be restated to $62·253 million ($70·253m – $8m). Gearing would subsequently become 54·1% (50/10 + 20·151 + 62·253). Furthermore, retained earnings would be further reduced by correcting for rental receipts. These presumably have been included in profit or loss rather than deducted from the net investment in the lease. This would in part be offset by interest income which should be recorded in profit or loss at the effective rate of interest. After correcting for these errors, Fiskerton would be in breach of their debt covenants. They have a negative cash balance and would appear unlikely to be able to repay the loan. Serious consideration should therefore be given as to whether Fiskerton is a going concern. It is likely that non-current assets and non-current liabilities should be reclassified to current and recorded at their realisable values. As an absolute minimum, should Fiskerton be able to renegotiate with the bank, the uncertainties surrounding their ability to continue to trade would need to be disclosed.

(b) At the inception of the contract, Fiskerton must determine whether its promise to construct the asset is a performance obligation satisfied over time. Fiskerton only has rights during the production of the asset over the initial deposit paid. They have no enforceable rights to the remaining balance as construction takes place. Therefore they would not be able to receive payment for work performed to date. Additionally, Fiskerton has to repay the deposit should they fail to complete the construction of the asset in accordance with the contract. There is a single performance obligation which is only met on delivery of the asset to the customer. Revenue should not be recognised on a stage of completion basis but must be deferred and recognised at a point of time. That is, on delivery of the asset to the customer.

(c) It is concerning that the property has been incorrectly classified as an investment property. Accountants have an ethical duty to be professionally competent and act with due care and attention. It is fundamental that the financial statements comply with the accounting standards and principles which underpin them. This may be a genuine mistake but even so would not be one expected from a professionally qualified accountant. The financial statements must comply with the fair presentation principles embedded within IAS 1 *Presentation of Financial Statements*.

The managing director appears to be happy to manipulate the financial statements. A self-interest threat arises from the issue over the debt covenants. It is likely that the managing director is concerned about his job security should the bank recall the debt and deem Fiskerton to no longer be a going concern. It appears highly likely that the revaluation was implemented in the interim financial statements to try to maintain a satisfactory gearing ratio. Even more concerning is that the managing director has deliberately overstated the valuation for the year-end financial statements, even though he is aware that it breaches accounting standards. Such deliberate manipulation is contrary to the ethical principles of integrity, professional behaviour and objectivity. It appears that the managing director is trying to defraud the bank by misrepresenting the liquidity of the business to avoid repayment of the loan. This would be in breach of anti-money laundering regulations.

The sales contract is further evidence that the managing director may be attempting to manipulate the financial statements. The proposed treatment will overstate both revenue and assets which would improve the gearing ratio. A governance issue arises from the behaviour of the managing director. It is important that no one individual is too powerful and domineering in running an entity's affairs. An intimidation threat arises from the managing director pressurising the accountant to overstate revenue from the contract. It was also the managing director who implemented the excessive revaluations on the property. It would appear that the managing director is exercising too much power over the financial statements. The accountant must not be influenced by the behaviour of the managing director and should produce financial statements which are transparent and free from bias. Instead, the managing director should be reminded of their ethical responsibilities. The accountant may need to consider professional advice should the managing director refuse to correct the financial statements.

3 (a) (i) The *Framework* acknowledges a variety of measurement bases including historical cost, current cost, net realisable value (NRV) and present value. It refers to NRV as a settlement value which will be determined by a future transaction. Thus in order to determine NRV, the directors would need to refer to IAS 2 *Inventories* for the definition and IAS 10 *Events after the Reporting Date*. The directors should consider any adjusting events which provide evidence of conditions which existed at the end of the reporting period in order to determine NRV.

IAS 2 defines NRV as the estimated selling price in the ordinary course of business less the costs of completion and costs of sale. In this case, the NRV will be determined on the basis of conditions which existed at the date of the statement of financial position. IFRS 13 *Fair Value Measurement* does not apply to IAS 2 as regards NRV even though the measurement method is very similar. Any future price movements will be considered if they provide information about the conditions at the date of the statement of financial position but normally these movements would reflect changes in the market conditions after that date and therefore would not affect the calculation of NRV. The NRV will be based upon the most reliable estimate of the amounts which will be realised for the coal. The year-end spot price will provide good evidence of the realisable value of the inventories and where the company has an executory contract to sell coal at a future date, then the use of the forward contract price may be appropriate. However, if the contract is not executory but is a financial instrument under IFRS 9 *Financial Instruments* or an onerous contract recognised as a provision under IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, it is unlikely to be used to calculate NRV.

(ii) Fill should calculate the NRV of the low carbon coal using the forecast market price based upon when the inventory is expected to be processed and realised. Future changes in the forecast market price or the processing and sale of the low carbon coal may result in adjustments to the NRV. As these adjustments are changes in estimates, IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* will apply with the result that such gains and losses will be recognised in the statement of profit or loss in the period in which they arise.

(b) IAS 16 *Property, Plant and Equipment* (PPE) requires an entity to recognise in the carrying amount of PPE, the cost of replacing part of such an item. When each major inspection is performed, its cost is recognised in the carrying amount of the item of PPE as a replacement if the recognition criteria are satisfied. Any remaining carrying amount of the cost of a previous inspection is derecognised. The costs of performing a major reconditioning are capitalised if it gives access to future economic benefits. Such costs will include the labour and materials costs ($3 million) of performing the reconditioning. However, costs which do not relate to the replacement of components or the installation of new assets, such as routine maintenance costs, should be expensed as incurred.

It is not acceptable to accrue the costs of reconditioning equipment as there is no legal or apparent constructive obligation to undertake the reconditioning. As set out above, the cost of the reconditioning should be identified as a separate component of the mine asset at initial recognition and depreciated over a period of two years. This will result in the same amount of expense being recognised as the proposal to create a provision.

IAS 36 *Impairment of Assets* says that at the end of each reporting period, an entity is required to assess whether there is any indication that an asset may be impaired. IAS 36 has a list of external and internal indicators of impairment. If there is an indication that an asset may be impaired, then the asset's recoverable amount must be calculated.

Past and future reductions in selling prices may indicate that the future economic benefits which relate to the asset have been reduced. Mining assets should be tested for impairment whenever indicators of impairment exist. Impairments are recognised if a mine's carrying amount exceeds its recoverable amount. However, the nature of mining assets is that they often have a

long useful life. Commodity prices can be volatile but downward price movements are more significant if they are likely to persist for longer periods. In this case, there is evidence of a decline in forward prices. If the decline in prices is for a significant proportion of the remaining expected life of the mine, this is more likely to be an impairment indicator. It appears that forward contract prices for two years out of the three years of the mine's remaining life indicate a reduction in selling prices. Based on market information, Fill has also calculated that the three-year forecast price of coal will be 20% lower than the current spot price (part (a) of question).

Short-term market fluctuations may not be impairment indicators if prices are expected to return to higher levels. However, despite the difficulty in making such assessments, it would appear that the mining assets should be tested for impairment.

(c) The ED *Conceptual Framework for Financial Reporting* states that an entity controls an economic resource if it has the present ability to direct the use of the economic resource and obtain the economic benefits which flow from it. An entity has the ability to direct the use of an economic resource if it has the right to deploy that economic resource in its activities. Although control of an economic resource usually arises from legal rights, it can also arise if an entity has the present ability to prevent all other parties from directing the use of it and obtaining the benefits from the economic resource. For an entity to control a resource, the economic benefits from the resource must flow to the entity instead of another party.

Although the ED gives some guidance on the definition of control, existing IFRS Standards also provide help in determining whether Fill controls the mine and therefore should account for it as a business combination. IFRS 10 *Consolidated Financial Statements* states that an investor controls an investee when it is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. Further, IFRS 15 *Revenue from Contracts with Customers* lists indicators of the transfer of control of an asset to a customer. One of the indicators is that the customer has the significant risks and rewards of ownership of the asset which is basically exposure to significant variations in the amount of economic benefits.

A business combination is defined in IFRS 3 *Business Combinations* as a transaction or other event in which an acquirer obtains control of one or more businesses. A business is further defined as 'an integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing a return…..' Thus, the producing mine represents a business and Fill now owns a majority of the interest in the business.

However, this is not a business combination as Fill does not have the ability to affect decisions unless another participant agrees to vote with Fill. Although Fill will control 52% of the mine, it cannot direct the use of the economic resource unless one of the other participants agrees with an operating decision proposed by Fill and approval is given by 72% of participants. However, Fill can prevent the other parties from directing the use of the mine if the purchase goes ahead, because the other two parties cannot make an operating decision without Fill's consent.

Prior to the purchase of the additional investment, the approval of decisions required agreement by 72% of the participating interests. A joint control situation existed between the entities. Following the additional purchase, if there is still a joint control situation, the acquisition of an additional interest in a joint operation should apply all of the principles on business combinations accounting in IFRS 3 and other IFRS Standards with the exception of those principles which conflict with the guidance in IFRS 11 *Joint Arrangements*. These requirements can apply also to the initial acquisition of an interest in a joint operation. For there to be a joint control situation, there must be an agreement signed by the venturers which stipulates which of the parties are required to give unanimous consent.

4 (a) (i) The IFRS Practice Statement *Management Commentary* provides a broad, non-binding framework for the presentation of management commentary. The Practice Statement is not an IFRS Standard. Consequently, entities applying IFRS Standards are not required to comply with the Practice Statement, unless specifically required by their jurisdiction. Furthermore, non-compliance with the Practice Statement will not prevent an entity's financial statements from complying with IFRS Standards.

It can be argued that the International Accounting Standards Board's (the Board) objectives of enhancing consistency and comparability may not be achieved if the framework is not mandatory. A standard is more likely to guarantee a consistent application of the principles and practices behind the management commentary (MC).

However, it is difficult to create a standard on the MC which is sufficiently detailed to cover the business models of every entity or be consistent with all IFRS Standards. Some jurisdictions take little notice of non-mandatory guidance but the Practice Statement provides regulators with a framework to develop more authoritative requirements.

The Practice Statement allows companies to adapt the information provided to particular aspects of their business. This flexible approach could help generate more meaningful disclosures about resources, risks and relationships which can affect an entity's value and how these resources are managed. It provides management with an opportunity to add context to the published financial information, and to explain their future strategy and objectives without being restricted by the constraints of a standard.

If the MC were a full IFRS Standard, the integration of management commentaries and the information produced in accordance with IFRS Standards could be challenged on technical grounds, as well as its practical merits. In addition, there could be jurisdictional concerns that any form of integration might not be accepted by local regulators.

(ii) The *Framework* states that 'an essential quality of the information provided in financial statements is that it is readily understandable by users'. The MC should be written in plain language and a style appropriate to users' needs. The primary users of management commentary are those identified in the *Conceptual Framework*. The form and content

of the MC will vary between entities, reflecting the nature of their business, the strategies adopted and the regulatory environment in which they operate. Users should be able to locate information relevant to their needs.

Information has the quality of relevance when it has the capacity to influence the economic decisions of users by helping them evaluate past, present or future events or confirming, or correcting, their past evaluations. Relevant financial information is capable of making a difference to the decision made by users. In order to make a difference, financial information has predictive value, confirmatory value or both. The onus is on management to determine what information is important enough to be included in the MC to enable users to 'understand' the financial statements and meet the objective of the MC. If the entity provides too much information, it could reduce its relevance and understandability. If material events or uncertainties are not disclosed, then users may have insufficient information to meet their needs.

However, unnecessary detail may obscure important information especially if entities adopt a boiler-plate approach. If management presents too much information about, for example, all the risks facing an organisation, this will conflict with the relevance objective. There is no single optimal number of disclosures but it is useful to convey their relative importance in a meaningful way.

Comparability is the qualitative characteristic which enables users to identify and understand similarities and differences amongst items. It is important for users to be able to compare information over time and between entities. Comparability between entities is problematic as the MC is designed to reflect the perspectives of management and the circumstances of individual entities. Thus, entities in the same industry may have different perceptions of what is important and how they measure and report it. There are some precedents on how to define and calculate non-financial measures and financial measures which are not produced in accordance with IFRS Standards but there are inconsistencies in the definition and calculation of these measures.

It is sometimes suggested that the effectiveness of the overall report may be enhanced by strengthening the links between financial statements and the MC. However, such suggestions raise concerns about maintaining a clear distinction between the financial statement information and other information.

An entity should ensure consistency in terms of wording, definitions, segment disclosures, etc between the financial statements and the MC to improve the understanding of financial performance.

(b) Current tax is based on taxable profit for the year. Taxable profit is different from accounting profit due to temporary differences between accounting and tax treatments, and due to items which are never taxable or tax deductible. Tax benefits such as tax credits are not recognised unless it is probable that the tax positions are sustainable.

The Group is required to estimate the corporate tax in each of the many jurisdictions in which it operates. The Group is subject to tax audits in many jurisdictions; as a result, the Group may be required to make an adjustment in a subsequent period which could have a material impact on the Group's profit for the year.

Tax reconciliation

The tax rate reconciliation is important for understanding the tax charge reported in the financial statements and why the effective tax rate differs from the statutory rate.

Most companies will reconcile the group's annual tax expense to the statutory rate in the country in which the parent is based. Hence the rate of 22% is used in the tax reconciliation. It is important that the reconciliation explains the reasons for the differences between the effective rate and the statutory rate. There should be minimal use of the 'other' category. In this case, the other category is quite significant ($14 million) and there is no explanation of what 'other' constitutes.

One-off and unusual items can have a significant effect on the effective tax rate, but financial statements and notes often do not include a detailed discussion of them. For example, the brand impairment and disposals of businesses should be explained to investors, as they are probably material items. The explanation should include any potential reversal of the treatment.

Some profits recognised in the financial statements are non-taxable such as the tax relating to non-taxable gains on disposals of businesses and in some jurisdictions, taxation relief on impairment losses will not be allowable for taxation. The reasons for these items not being allowed for taxation should be explained to investors.

Tax rates

As the Group is operating in multiple countries, the actual tax rates applicable to profits in those countries are different from the local tax rate. The overseas tax rates are higher than local rates, hence the increase in the taxation charge of $10m. The local rate is different from the weighted average tax rate (27%) of the Group based on the different jurisdictions in which it operates. Investors may feel that using the weighted tax rate in the reconciliation gives a more meaningful number because it is a better estimate of the tax rate the Group expects to pay over the long term. Investors will wish to understand the company's expected long-term sustainable tax rate so they can prepare their cash flow or profit forecasts.

Information about the sustainability of the tax rate over the long term is more important than whether the rate is high or low compared to other jurisdictions. An adjustment can be made to an investor's financial model for a long-term sustainable rate, but not for a volatile rate where there is no certainty over future performance. For modelling purposes, an understanding of the actual cash taxes paid is critical and the cash paid of $95 million can be found in the statement of cash flows.

Deferred taxation

Provision for deferred tax is made for temporary differences between the carrying amount of assets and liabilities for financial reporting purposes and their value for tax purposes. The amount of deferred tax reflects the expected recoverable amount and is based on the expected manner of recovery or settlement of the carrying amount of assets and liabilities, using the basis of taxation enacted or substantively enacted by the financial statement date.

Deferred tax assets are not recognised where it is more likely than not that the assets will not be realised in the future and reference to IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* is useful in this regard. The evaluation of deferred tax assets' recoverability requires judgements to be made regarding the availability of future taxable income.

Management assesses the available evidence to estimate if sufficient future taxable income will be generated to use the existing deferred tax assets. A significant piece of objective negative evidence evaluated was the loss incurred in the period prior to the period ended 30 November 20X7. Such objective evidence may limit the ability to consider other subjective evidence such as projections for future growth. Deferred taxes are one of the most difficult areas of the financial statements for investors to understand. Thus there is a need for a clear explanation of the deferred tax balances and an analysis of the expected timing of reversals. This would help investors see the time period over which deferred tax assets arising from losses might reverse. It would be helpful if the company provided a breakdown of which reversals would have a cash tax impact and which would not.

As the proposed tax law was approved, it is considered to be enacted. Therefore, the rate of 25% should be used to calculate the deferred tax liability associated with the relevant items which affect deferred taxation.

At 30 November 20X7, Holls has deductible temporary differences of $4·5 million which are expected to reverse in the next year. In addition, Holls also has taxable temporary differences of $5 million which relate to the same taxable company and the tax authority. Holls expects $3 million of those taxable temporary differences to reverse in 20X8 and the remaining $2 million to reverse in 20X9. Thus a deferred tax liability of $1·25 million ($5 million x 25%) should be recognised and as $3 million of these taxable temporary differences are expected to reverse in the year in which the deductible temporary differences reverse, Holls can also recognise a deferred tax asset for $0·75 million ($3 million x 25%). The recognition of a deferred tax asset for the rest of the deductible temporary differences will depend on whether future taxable profits sufficient to cover the reversal of this deductible temporary difference are expected to arise. Deferred tax assets and liabilities must be recognised gross in the statement of financial position. However, it may be possible to offset the deferred tax assets and the deferred tax liabilities if there is a legally enforceable right to offset the current income tax assets against current income tax liabilities as the amounts relate to income tax levied by the same taxation authority on the same taxable entity.

After the enactment of a new tax law, when material, Holls should consider disclosing the anticipated current and future impact on their results of operations, financial position, liquidity, and capital resources. In addition, Holls should consider disclosures in the critical accounting estimates section of the management commentary to the extent the changes could materially affect existing assumptions used in making estimates of tax-related balances. Changes in tax laws and rates may affect recorded deferred tax assets and liabilities and the effective tax rate in the future.

			Marks	Marks
1	**(a)**	**(i)** – calculation of cash flow generated from operations	6	
		(ii) – explanation of the adjustments and use of the scenario	6	12
	(b)	– application of the following discussion to the scenario:		
		purchase consideration (shares and deferred cash)	1	
		impact on consolidated statement of cash flows of:		
		subsidiary acquisition (including dividend)	3	
		subsidiary disposal	2	6
	(c)	– IFRS 5 definition of discontinued operation and application to the scenario	3	
		– consideration of held for sale and application to the scenario	1	
		– consideration of loss of control and application to the scenario	2	6
	(d)	– inconsistent application of the probability criterion (including examples)	3	
		– proposed changes to the recognition criteria	3	6
				30
2	**(a)**	– application of the following discussion to the scenario:		
		correct accounting treatment of the lease	3	
		implications for the financial statements	2	
		implications for the debt covenant	2	7
	(b)	– consideration of whether it is performance satisfied over time or at a point in time and application to the scenario	3	
		– conclusion and implications for revenue	1	4
	(c)	– application of the following discussion of ethical issues to the scenario:		
		classification of property as investment property	2	
		revaluation and manipulation of the debt covenant	3	
		– consideration of the ethical implications and their resolution	2	7
		Professional		2
				20
3	**(a)**	– a discussion of potential measurement basis, NRV and relevant Standards	4	
		– application of IAS 2 to the scenario	3	7
	(b)	– a discussion of IAS 16 and application to the scenario	4	
		– a discussion of IAS 36 and application to the scenario	4	8
	(c)	– a discussion of control in the ED *Conceptual Framework* and other relevant Standards	4	
		– a discussion of a business combination per IFRS 3	2	
		– application of the above discussions to the scenario	4	10
				25

				Marks	Marks
4	**(a)**	**(i)**	– arguments for and against the non-binding framework		4
		(ii)	– a discussion of understandability, relevance and comparability	3	
			– application of the above characteristics to MC	2	5
	(b)		– an explanation of why taxable profits are different from accounting profit	2	
			– application of the following explanations to the scenario:		
			tax reconciliation	4	
			tax rates	3	
			deferred taxation	5	14
			Professional marks		2
					25

Note: In each question, some marks are allocated for RELEVANT knowledge. Marks will not be awarded for the reproduction of irrelevant knowledge or irrelevant parts of IFRS Standards. Full marks cannot be gained unless relevant knowledge has been applied. Candidates may also discuss issues which do not appear in the suggested solution. Providing that the arguments made are logical and the conclusions derived are substantiated, then marks will be awarded accordingly.