Answers

1 (a) Cash paid to acquire Flour Co

The acquisition of Flour Co is a step acquisition. This means the original 40% equity interest is treated as if it is disposed and then reacquired at fair value. The difference between the carrying amount of the original 40% equity interest and its fair value would be included as a gain within profit or loss. As an associate, the investment would have been accounted for using the equity method and would be valued at $14·8 million as at 1 July 20X7:

	$000
Cost	10,000
Share of increase in net assets between acquisition dates ($12m x 40%)	4,800
Investment in associate as at 1 July 20X7	14,800

The fair value of the original 40% interest would be $15·2 million (10m x 40% x $3·80) and so gain of $400,000 would be included within profit or loss.

Goodwill will be calculated at 1 July 20X7, the date that control is gained, as the difference between the fair value of the consideration and non-controlling interest and the fair value of the identifiable net assets at acquisition. The consideration must include the fair value of the original 40% equity interest as well as the fair value of the additional consideration.

The fair value of the non-controlling interest at 1 July 20X7 will be $11·4 million (10m x 30% x $3·80).

The fair value of the share exchange will be $9 million. (3 million shares acquired x ½ x $6).

Goodwill has been determined to be $2,259,000 which means the cash paid to acquire Flour Co on 1 July 20X7 must be $3 million as follows:

	$000
Fair value of original 40% equity interest	15,200
Fair value of share exchange	9,000
Fair value of non-controlling interest at acquisition	11,400
Fair value of identifiable net assets at acquisition including FV uplift ($35,741 + $600)	(36,341)
Cash Consideration (balancing figure)	3,000
Goodwill on acquisition per question	2,259

Cash paid to acquire Flour Co will be included within the investing activities of the consolidated statement of cash flows. However, the cash held by Flour Co will now be consolidated so a net outflow arises of $1,766,000 ($3m – $1·234m).

(b) Extracts from the consolidated statement of cash flows for the Sugar Group year ended 30 June 20X8

Cash flows from investing activities

	$000
Net cash paid on acquisition of Flour Co (part a)	(1,766)
Cash paid to acquire intangible assets (W1)	(12,051)
Proceeds from disposal of property plant and equipment (W2)	4,370
Cash paid on acquisition of Butter Co (given in q)	(5,000)
Dividends received from associates (W3)	2,253
Proceeds from disposal of FVTPL investment ($4m + $0·5m)	4,500
Investment income received (W4)	1,991

Cash flows from financing activities

	$000
Issue of ordinary shares during the year (W5)	9,600
Dividends paid to the non-controlling interest (W6)	(3,324)

Workings 1
Intangibles

	$000
Intangibles b/f	15,865
Goodwill on acquisition of Sugar Co	2,259
Licences and patents on acquisition of Sugar Co	6,781
Amortisation	(3,500)
Cash purchases of Intangibles (balancing figure)	12,051
Intangibles c/f	33,456

Working 2
Property, plant and equipment

	$000
Property, plant and equipment b/f	52,818
Acquisition of Flour Co (at fair value)	18,676
Depreciation	(10,000)
Carrying value of disposal (balancing figure)	(6,370)
Property, plant and equipment c/f	55,124

Since the asset was sold at a loss of $2 million disposal proceeds must have been only $4,370 ($6·37m – $2m).

Working 3
Dividends received from associates

	$000
Investment in associates b/f	23,194
Associate profit for the year	15,187
Acquisition of Butter Co	5,000
Step acquisition Sugar Co (part a)	(14,800)
Dividends received (balancing figure)	(2,253)
Investment in associate c/f	26,328

Working 4
FV gains recognised in investment income

	$000
FVTPL asset b/f	6,000
Carrying amount of disposal	(4,000)
Fair value gains included in investment income (balancing figure)	1,000
FVTPL asset c/f	3,000

	$000
Investment income per PL	3,891
FV gains on FVTPL investments	(1,000)
Fair value gains on step acquisition	(400)
Profit on disposal of FVTPL	(500)
Investment income received	1,991

Proceeds from the disposal of the FVTPL asset are $4·5 million ($4m + $0·5m)

Tutorial note: *The fair value gain is included within investment income but is not a cash flow and so will be excluded from the consolidated statement of cash flows. In addition there is a $400,000 gain arising upon the step acquisition of Flour Co included within the investment income but isn't a cash flow. The profit on disposal of $0·5 million is also not a cash flow but forms part of the proceeds from the disposal of FVTPL assets within investing activities. Cash proceeds included within the investment income of the group are therefore $1,991,000.*

Working 5
Issue of ordinary shares during the year

	$000
Share capital and share premium b/f ($20m + $18m)	38,000
Share for share exchange (part a)	9,000
Cash proceeds from issue of shares during the year (balance)	9,600
Share capital and share premium c/f ($23m + $33·6m)	56,600

Working 6
Dividends paid to non-controlling interest

	$000
Non-controlling interest b/f	12,914
Added on acquisition of Flour Co (part a)	11,400
Non-controlling interest profit for the year	9,162
Dividends paid to non-controlling interest (balancing figure)	(3,324)
Non-controlling interest c/f	30,152

(c) The only cash flow that should be recorded in the consolidated statement of cash flows in relation to defined benefit pension schemes are the contributions paid into the scheme. These are typically included within the operating activities of the group statement of cash flows. Since Sugar Co did not make any contributions until after the year-end there will be no cash flows to include in the consolidated statement of cash flows for the year ended 30 June 20X8. The $2 million benefits paid out of the scheme are a cash outflow but they are an outflow of cash from the pension scheme itself, a separate entity, rather than a cash outflow of Sugar Co.

This does not mean that the pension scheme will not have any impact upon the consolidated statement of cash flows of the Sugar group. Since operating activities are being calculated using the indirect method it is necessary to adjust for any items that effect operating profit but are not cash flows. This would include the service cost component which would need to be added back to group profits. Care would also need to be taken in calculating the interest paid in the year. The finance cost charge in the profit and loss would include the net interest charge from unwinding the opening value of the liabilities and the estimated return on the assets. Neither of these are cash flows and so would require adjusting. The remeasurement component is included as part of other comprehensive impact and will not impact on the group statement of cash flows since it is not a cash flow, nor does it impact upon operating profit.

2 **(a)** The performance obligation will be satisfied upon the completion of construction which is also when the title, possession and control of the apartment block pass to the customer. The advanced payment represents a significant financing component and IFRS 15 *Revenue from Contracts with Customers* states that where this is the case then revenue is recognised at an amount that reflects the price that a customer would have paid if the customer had paid cash when they transfer the goods to the customer. IFRS 15 also states that the interest rate used should reflect the credit characteristics of the party receiving financing but may be the rate that discounts the nominal amount of the promised consideration to the price that the customer would pay in cash. In this case, the interest rate would be 6%. Using this rate, the cash sales price of $9·55 million can be discounted to $8·5 million. Calibra Co should recognise a liability of $8·5 million and should subsequently accrue interest on this liability balance for two years until it reaches $9·55 million when the performance obligation is satisfied.

The interest should be accounted for in accordance with IAS 23 *Borrowing Costs* as part of the cost of constructing the apartment block. As Calibra Co's business model is based on construction, IAS 23 states that borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset form part of the cost of that asset and, therefore, in this case should be included in the cost of inventory production. Other borrowing costs are recognised as an expense.

(b) **Journal entries**

	Dr ($m)	Cr ($m)
Cash	8·5	
Liability		8·5
Records liability on receipt of cash (1/1/X8)		
Inventory: Interest accruing to 31/12/X8	0·51	
Liability		0·51
Interest accruing on liability to 31/12/X8 (6% x 8·5m) included in the costs of inventory		
Inventory: Interest accruing to 31/12/X9	0·54	
Liability		0·54
Interest accruing on liability to 31/12/X9 (6% x (8·5 + 0·51)) included in the costs of inventory		
Liability	9·55	
Revenue		9·55
Revenue arising on sale of apartment block (per question)		

The balance on the contract liability at 31/12/X8 would be $9·55 million (8·5 + 0·51 + 0·54). When control passes to the customer, Calibra Co recognises revenue of $9·55 million.

(c) The chief accountant should not hold himself out as having an understanding of distributed ledgers if he only has a basic knowledge. He should have seen evidence of whether the technology can be scaled up to the requirements of the directors before promising them that he can facilitate the move. Also, he must convince himself that the reliability of the due diligence on the sale of property shares and that local regulations are complied with. In order to maintain integrity, professional accountants must be honest about whether they are comfortable with their knowledge of managing projects such as this. The chief accountant should not manage the project if he has doubts as to his knowledge as there may be significant issues as the project progresses. There may be a need to engage specialist consultancy input from distributed ledger experts. Similarly, the chief accountant should behave in a professional manner and determine whether the data on the distributed ledger breaks any confidentiality principles. He will need to consider the fact that local regulations may be violated and the repercussions thereof. The technology allows resale of the shares in the property and given the chief accountants worries over due diligence, illegal transfers of title ownership could be costly and time consuming to resolve. The chief accountant must also exercise independence of mind and not bow to political pressure from the board even though it may be a high-profile project for the company. He should inform the board of his reservations based upon his opinion and technical knowledge.

One of the main concerns for accounting professionals is the fear of losing objectivity in their judgment due to pressures from clients, employers, or other stakeholders. This occurrence would create a loss of professional identity for the person concerned. Some individuals are more vulnerable to loss of objectivity than others. Young accountants at the beginning of their career could be considered a vulnerable group, as they may be more easily influenced due to a perceived lack of experience and pressures from senior colleagues. The accountant has only just qualified and so might be inexperienced to be in the position of chief accountant. In this case, he has created a self-interest threat as the chief accountant has a personal interest in allowing Bodoni Co to pay the reduced amount 1 month after the contract for the purchase of the apartment block has been signed, as he wishes a good reference from the client when he applies for the permanent position. The pressure of applying for this position has inappropriately influenced his professional judgement and behaviour. Additionally, there is a threat to the chief accountant's objectivity which stems from a self-interest threat from the fear of losing Bodoni Co as a client which in turn would affect the accountant's chances of securing his position on a permanent basis.

3 **(a)** There are many challenges in recognising and measuring intangible assets such as brands in the statement of financial position.

Many intangible assets are not frequently traded on a stand-alone basis and therefore very often there is no active market for them which makes arriving at a valuation more difficult. Additionally, many intangible assets are unique and therefore it is not easy to identify and assess their value. Valuation methods are often complex and subjective and the measurement is more subjective when the intangible assets are not based on legally enforceable rights. In some cases, the acquirer does not intend to use the intangible assets (for example, Corbel has acquired the brands for defensive reasons) and this raises issues with regards to arriving at a value. Finally, determining the useful life of intangible assets can be subjective.

Generally, the reason for the omission from the financial statements of intangible assets has been due to a perceived lack of a link between their costs and estimating future revenue. In addition, the difficulties in ascertaining cost or valuation figures for intangibles and a focus on reliability over relevance when disclosing asset information have meant that internally generated intangibles have not usually been recognised. However, the importance of intangibles is reflected in the increasing proportion of a company's market value being attributable to the existence of intangibles.

Intangible assets are not physical assets that can be easily recognised. In some cases, perceptions may clash and what may seem like an intangible asset to one party may appear not so to another.

(b) **(i)** The Jengi brand will generate future economic benefits by increasing sales volumes and by the potential of premium prices. Control over these potential future benefits is achieved by the registration of the brand. The registration also satisfies the requirement to identify the intangible asset separately from goodwill and estimate its fair value.

IAS 36 *Impairment of Assets* defines a cash generating unit (CGU) as the smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or other groups of assets. However, brands are typically not a separate CGU under IFRS. The brand would be tested for impairment together with the associated manufacturing facilities. The brand would be separately identified and valued, and should be allocated to each of Corbel Co's cash generating units that are expected to benefit from the synergies of the combination. IAS 36 recognises that sometimes there is no basis for allocating the brand to an individual CGU that is not arbitrary, so it permits it to be allocated to a group of CGUs. However, each CGU must represent the lowest level within the entity that is monitored for internal management purposes and not be larger than an operating segment.

(ii) Intangible assets have an indefinite useful life when there is no foreseeable limit to the period over which, based on an analysis of all relevant factors, the asset is expected to generate net cash inflows for the entity (IAS 38 *Intangible Assets*). An intangible asset with an indefinite useful life should not be amortised. IAS 36 *Impairment of Assets*, requires an entity to test an intangible asset with an indefinite useful life for impairment by comparing its recoverable amount with its carrying amount:

(a) annually, and
(b) whenever there is an indication that the intangible asset may be impaired.

The useful life of an intangible asset that is not being amortised should be reviewed each period to determine whether events and circumstances continue to support an indefinite useful life assessment for that asset. If they do not, the change in the useful life assessment from indefinite to finite should be accounted for as a change in an accounting estimate in accordance with IAS 8 *Account Policies, Changes in Estimates and Errors*.

Corbel Co should consider various factors to determine whether the brand names can be considered to have a useful life. These will include the extent to which Corbel Co is prepared to support the brand and the extent to which the brand has long-term potential and has had proven success. Perfume is often subject to market and fashion trends and therefore, an assessment of how resistant the brands are to change should be made. Also Corbel Co has purchased the brands as a defensive measure to prevent rival companies acquiring them. Therefore, there may be a doubt as to the support that Corbel Co may be prepared to give to the brands.

The Locust perfume has been sold successfully in the market for many years and could be deemed to have an indefinite life. The Clara perfume is linked to the popularity of the actor and therefore, it is difficult to assess whether the brand has an indefinite life as it is likely to be dependent upon the longevity of the popularity of the actor. In the case of the Clara perfume, it is difficult to state that the brand will have an indefinite life. Thus Clara is likely to have a finite life.

(iii) IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* states that immediately before classifying a disposal group as held for sale, the carrying amounts of the assets and liabilities within the group are measured in accordance with the applicable IFRS standards. After classification as held for sale, disposal groups are measured at the lower of carrying amount and fair value less costs to sell. Impairment must be considered both at the time of classification as held for sale and subsequently after classification. The six stores should be accounted for as a discontinued operation as they represent a component of Corbel Co and are a separate geographical area of operations. The approval and announcement of a plan to close the six Italian stores is an indication that the assets attributable to the discontinuing operation may be impaired. In addition, the six stores would be classified as a 'disposal group' which is a group of assets that, an entity intends to dispose of in a single transaction. The measurement basis required for non-current assets classified as held for sale is applied to the group as a whole, and any resulting impairment loss reduces the carrying amount of the non-current assets in the disposal group in the order of allocation required by IAS 36. Additionally, there may be a need to provide for the additional costs of closure such as redundancy costs, under IAS 37 *Provisions, Contingent liabilities and Contingent Assets*.

At the end of each reporting period, an entity is required to assess whether there is any indication that an asset may be impaired, i.e. its carrying amount may be higher than its recoverable amount. 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. Whenever there is an indication of impairment, the entity estimates the recoverable amount of the asset and records an impairment if the recoverable amount is lower than the carrying amount.

Although there has been a local newspaper article that Corbel Co is to shut 30 stores with a loss of 500 jobs across the world over the next five years, there has been no formal announcement by Corbel Co and therefore, until there has been formal plans drawn up to close the additional stores there should be no provisions made for the stores potential closure and loss of jobs. It is feasible that the closure of the additional 24 stores will not take place, and there is no constructive obligation unless there is at least a detailed formal plan. The directors have denied the fact that the additional stores will be closed.

(iv) As stated in (a)(ii), an entity needs to assess at the end of each reporting period whether there is any indication that an asset may be impaired. An indication of impairment is whether the performance of the asset is worse than expected. As the primary store is performing in line with expectations, it would appear that at present, there is no indication of impairment and therefore no impairment test is required. Additionally, if Corbel Co feels that the primary store benefits all the other stores from a brand perspective, it may be appropriate to treat the store as a corporate asset and allocate its cost to the other stores for impairment testing. The amount of internet sales included in any impairment assessment of the primary store will depend on the quantity of sales that are sourced directly from it. Where Internet sales are sourced from a central warehouse or another store, the cash inflows should be excluded from the primary store's impairment assessment and included in the appropriate CGU.

4 (a) (i) The principal aim when developing IFRS for SMEs was to provide a framework that generated relevant, reliable and useful information and the provision of a high quality and understandable accounting standard suitable for SMEs. The Standard itself is self-contained, and incorporates accounting principles based on full IFRS standards. It comprises a single standard divided into simplified sections for each relevant IFRS standard but which have also omitted certain IFRS standards such as earnings per share and segmental reporting. In addition, there are certain accounting treatments that are not allowable under the SMEs Standard. For example, there is no separate guidance for non-current assets held for sale.

To this end, the SMEs Standard makes numerous simplifications to the recognition, measurement and disclosure requirements in full IFRS standards. Examples of these simplifications are:

– Intangible assets must be amortised over their useful lives. If the useful life is not determinable then it is presumed to be 10 years.

– The cost model (investment is measured at cost less any accumulated impairment losses) can be used for investments in associates. This model may not be used for investments for which there is a published price quotation, in which case the fair value model must be applied.

The disclosure requirements in the SMEs Standard are also substantially reduced when compared with those in full IFRS standards partly because they are not considered appropriate for users' needs and for cost-benefit considerations. Many disclosures in full IFRS standards are more relevant to investment decisions in capital markets than to the transactions undertaken by SMEs. The SME Standard is naturally a modified version of full IFRS standards, and not an independently developed standard. They are based on recognised concepts and pervasive principles and they will allow easier transition to full IFRS Standards if the SME decides to become a public listed entity.

(ii) IFRS for SMEs decreases information asymmetry between the firm and the users, because of its recognition, measurement and disclosure requirements. However, there are certain facts and information in companies which is not disclosed by them to investors under any accounting standards. SMEs have access to all relevant information, while investors lack much of the relevant information. Unfortunately, lack of relevant information will have an adverse effect on the decision-making of the investor. Information related to the SME's credit, project risk and benefits are known more by the SME than by the investor giving the SME an information advantage. Therefore, investors are in a relatively disadvantaged position, and if they, for example, are financial institutions, they will raise lending rates to reduce potential risk of credit losses or may not invest at all. The more incomplete and the less transparent the information from the SME, the higher will be the risk related to the investment and the higher will be the return that the investor requires. The access to investment by SMEs could be determined by the quality of financial statements, information asymmetry and perceived risk. Quality financial statements reduce the level of information asymmetry which reduces perceived risk.

(iii) Integrated reporting could help SMEs better understand and better communicate how they create value. It can provide a roadmap for SMEs to consider the multiple capitals that make up its value creation. An integrated report represents a more complete corporate report which will help SMEs understand their business so they can implement a business model that will help them grow. SMEs use a range of resources and relationships to create value. An integrated reporting approach helps SMEs build a better understanding of the factors that determine its ability to create value over time. Integrated thinking helps SMEs gain a deeper understanding of the mechanics of their business. This will help them assess the strengths of their business model and spot any deficiencies. These will create a forward-looking approach and sound strategic decision making.

Some SMEs have few tangible assets and operate in a virtual world. As such, conventional accounting will fail to provide a complete picture as to its ability to create value. Capitals, such as employee expertise, customer loyalty, and intellectual property, will not be accounted for in the financial statements which are only one aspect of an SME's value creation. As a result, SME stakeholders can be left with insufficient information to make an informed decision.

Integrated reporting will include key financial information but that information is alongside significant non-financial measures and narrative information. Integrated reporting can help fulfil the communication needs of financial capital and other stakeholders and can optimize reporting.

(b) (i) Handfood Co should recognise a liability for its obligations as a result of the additional employee benefit net of plan assets. The treatment for these payments is similar to a defined benefit pension scheme, but the difference is that any actuarial gains or losses are recognised immediately and not in other comprehensive income as Handfood Co does at present. Any service costs, net interest and remeasurements should all be recognised in profit or loss. In this case, Handfood Co is going to pay the benefit out of cash and therefore there will be no plan assets. Handfood Co will recognise the net annual change in that liability during the five year period as the service cost. The company will measure the benefit liability at the present value of its obligations at the reporting date. This amount is the estimated amount of benefit that employees have earned in return for their service in the current and prior periods, including benefits that are not yet vested. The benefit is based on future salaries, and therefore the projected unit credit method requires an entity to measure its defined benefit obligations on a basis that reflects estimated future salary increases. The components of the cost of the additional benefit will be recognised in profit or loss which includes the current service cost.

For the year ended 31 December 20X2

Handfood Co recognises a current service cost expense of $7,700 in profit or loss as set out below:

	$000
Expected final salary $1·1million x $(1·03)_4$	1,238
Benefit for the current year (1% x $1·238 million)	12·4
Adjusted benefit for the current year (75% x $12,400)	9·3
Current service cost (($9,300 x 0·823) discounted at 5% over 4 years)	7·7

This figure will be unwound each year and the movement recorded as the current service cost (in so far as no other changes to the assumptions are made)

(ii) An increase in employees' salaries above 3% per annum and a decrease in the probability of employees leaving the company would have the same effect on the additional benefit liability. The changes in the assumptions would both increase the benefit liability (discounted) at 31 December 20X3. This would in turn increase the current service cost for the year in profit or loss as the benefit payable on 1 January 20X7 will have increased as will the number of employees to whom the benefit will be payable.

Interest, which is calculated on the opening balance of the benefit obligation, will not be affected by the changes in assumptions. It will be charged to profit or loss at $385 ($7,700 x 5%). Actuarial gains or losses arise when the assumptions change. In this case because, of the changes in assumptions, an actuarial loss will arise because of the increase in benefits payable and the obligation and this will be charged to profit or loss.

			Marks	*Marks*
1	**(a)**	Application of the following discussion to the scenario:		
		– Treatment as an associate (including FV 40% and share exchange at 1 July 20X7)	5	
		– FV NCI and identifiable net assets at 1 July 20X7)	3	
		Goodwill Calculation and treatment of cash consideration	2	10
	(b)	Marks for calculations as follows:		
		Acquisition of Intangibles	3	
		Proceeds on disposal of PPE	3	
		Cash paid for Butter Co	1	
		Dividends received from associates	2	
		Investment income received	3	
		Issue of ordinary shares	2	
		Non-controlling interest dividend	2	16
	(c)	Application of the following discussion to the scenario:		
		– Cash flows to include/exclude	2	
		– Other elements of defined benefit scheme	2	4
				30
2	**(a)**	Application of the following discussion to the scenario:		
		– Revenue IFRS 15	3	
		– Borrowing costs IAS 23	2	5
	(b)	Journal entries		3
	(c)	Discussion and application of ethical principles to scenario		10
	Professional marks			2
				20
3	**(a)**	Listing of major challenges		
		1 mark per point up to maximum		5
	(b)	Discussion and application of the following to the scenario:		
		(i) Treatment of brand on acquisition	2	
		Allocation of brand to CGU	2	4
		(ii) Intangible assets with indefinite life principles (IAS 38)	2	
		Application to scenario	4	6
		(iii) NCA held for sale-principles	3	
		Application to scenario	3	6
		(iv) Impairment principles	2	
		Impairment of primary store	2	4
				25

				Marks	Marks
4	**(a)**	**(i)**	Discussion of IFRS for SMEs:		
			Simplifications and omissions	2	
			Disclosure	1	
			Recognised concepts	1	4
		(ii)	Discussion of:		
			Information asymmetry issues and investors knowledge		4
		(iii)	Discussion of Integrated Reporting:		
			Better understanding	2	
			Better communication	1	
			Nature of IR	2	5
	(b)	**(i)**	Discussion of principles of accounting for additional benefit liability/current service cost	4	
			Calculation of current service cost 20X2	2	6
		(ii)	Discussion of effect of change in assumptions		4
			Professional marks		2
					25