Answers

1 (a)

	$m
Assets	
Non-current assets	
Property, plant and equipment (W7)	2,348·1
Goodwill (W1)	108·8
Intangible assets (W8)	517
	2,973·9
Current assets (W9)	1,670
Current assets held for sale (W3)	1,796
	3,466
Total assets	6,439·9
Equity and liabilities	
Equity share capital of $1 each	2,100
Retained earnings (W12)	1,481·2
Other components of equity (W14)	212·3
	3,793·5
Non-controlling interest (W13)	238·4
Total equity	4,031·9
Non-current liabilities (W10)	1,159
Current liabilities (W11)	673
Current liabilities held for sale (W3)	576
	1,249
Total liabilities	2,408
Total equity and liabilities	6,439·9

Working 1 – Goodwill on acquisition of Butter

	$m	$m
Consideration		1,000
Non-controlling interest – (20% x $1,070)		214
		1,214
Fair value of identifiable net assets acquired:		
Share capital	620	
Retained earnings	344	
Other components of equity	46	
Fair value adjustment – intangibles (W8)	60	
		(1,070)
Goodwill on acquisition		144
Impairment (W2)		(35·2)
Goodwill at 31 December 2017		108·8

Working 2 – Impairment of Butter

As the non-controlling interest (NCI) of Butter is measured using the proportional method, goodwill should be grossed up by 100/80 so that it is comparable with the recoverable amount. $144m x 100/80 = $180m. Notional goodwill is therefore $36m ($180m – $144m). The net assets of Butter at 31 December 2017 are therefore as follows:

	$m
Share capital	620
Retained earnings	482
Other components of equity	78
Fair value adjustment – intangibles	60
Subsequent amortisation – intangibles ($60m x 4/5)	(48)
Goodwill per consolidated accounts	144
Notional goodwill	36
Total	1,372

Since the recoverable amount is only $1,328m, an impairment arises of $44m ($1,372m – $1,328m). Impairments of cash generating units are allocated initially to goodwill. This will be apportioned 80/20 between the goodwill recognised within the consolidated financial statements and the notional goodwill. Therefore the impairment to be adjusted for on consolidation is (80% x $44m) = $35·2 million (W1). All of this impairment will be charged to the profits of Bread and will therefore reduce their retained earnings by $35·2m (W12).

Working 3 – Jam

Goodwill in Jam would originally be calculated as $20m ($1,250m – $1,230m). The net assets Jam are now $1,292m at 31 December 2017 ($1,272m per question and $20m goodwill).

Since the group has a revaluation policy under IAS 16 *Property, Plant and Equipment*, the group must revalue the property plant and equipment of Jam to fair value of $340m on classification as held for sale. A gain of $10m ($340m – $330m) would be recorded within other components of equity (W14). The net assets of Jam would now have a carrying amount of $1,302m including $846m for property, plant and equipment. On classification as held for sale, Jam must be measured at the lower of carrying amount and fair value less costs to sell. An impairment arises of $82 million ($1,302m – $1,220m). This will first be allocated to the goodwill of $20m. The remaining impairment of $62 million is allocated to non-current assets to which the measurement requirements of IFRS5 *Non-current Assets Held for Sale and Discontinued Operations* apply. No impairment will therefore be allocated to the current assets of Jam.

Tutorial note:
The remaining impairment loss of $62 million should be allocated to property, plant and equipment and other intangible assets in proportion to their respective carrying amounts as follows:

Property, plant and equipment $62m x ($846m/($846m + $428m)) = $41m
Other intangible assets $62m x ($428m/($846m + $428m)) = $21m

or:

The table below summarises the allocation of the impairment:

	Carrying amount before reclassified as held for sale $m	*Allocated impairment*	*Carrying amount after allocation of impairment loss $m*
Goodwill	*20*	*(20)*	*Nil*
Property, plant and equipment	*846*	*(41)*	*805*
Other intangible assets	*428*	*(21)*	*407*
Current assets	*584*	*Nil*	*584*
Non-current liabilities	*(322)*	*Nil*	*(322)*
Current liabilities	*(254)*	*Nil*	*(254)*
Total	*1,302*	*(82) (W12)*	*1,220*

The assets and the liabilities of the disposal group should be separately presented within the current assets and current liabilities of the consolidated financial statements. $1,796m ($805m + $407m + $584m) or (836 + 10 + 428 – 62 + 584) will be included within current assets and $576m ($322m + $254m) within current liabilities.

Working 4 – Pension adjustment

The defined benefit scheme for the year should have been recorded as follows:

	$m
Net obligation at 31 December 2016	120
Cash contribution into the scheme	(100)
Net finance cost for the year ($120m x 5%)	6
Current service cost	55
Loss on curtailment	11
Gain on remeasurement	(9)
Net liability at 31 December 2017	83

The benefits paid do not affect the net liability for the year. Since only the cash contributions have been recorded for the year, the net obligation should be increased by $63m ($83m – $20m) (W10). $72 million should be expensed to profit or loss (W12) being the service cost component (current and curtailment) plus the interest charge. $9m should be credited to other components of equity being the gain on remeasurement (W14).

Working 5 – Share-based payment

The share-based payment is an equity settled scheme and the fair value of the options should be measured using the fair value at the grant date. An expense is charged against profits and spread over the three-year vesting period. A corresponding credit should be recorded within equity. The number of leavers each year and an estimate of future leavers should be considered as a non-market based vesting condition.

At 31 December 2017 (10,000 – 980 – 950 – 920) x 200 x $8 x 2/3 = $7·6m.

A further \$3·7m (\$7·6m – \$3·9m) should be charged to the profits of Bread (W12) with a corresponding increase in other components of equity (W14).

Working 6 – Joint operation

The manufacturing facility is classified as a joint operation as key decisions require unanimous consent and each party has rights to the facility. Bread has correctly included their \$50m share of the facility within property, plant and equipment but the asset should have been depreciated from 31 March 2017 as the facility was ready for use. The depreciation adjustment required is \$1·9m (\$50m/20 x 9/12).

Each investor should include a third of the profits from the facility within their individual accounts. An adjustment of \$19m (\$57m x 1/3) is required to the current assets of Bread (W9) and \$12m (\$36m x 1/3) should be added to their current liabilities (W11). Overall, the profits of Bread will increase by \$7m (\$19m – \$12m) (W12).

Working 7 – Property, plant and equipment

	$m
Bread	1,435
Butter	915
Depreciation manufacturing facility (W6)	(1·9)
	2,348·1

Working 8 – Intangibles

	$m
Bread	435
Butter	70
Fair value uplift	60
Subsequent amortisation (\$60m/5) x 4	(48)
	517

Working 9 – Current assets

	$m
Bread	865
Butter	786
Joint operation (W6)	19
	1,670

Working 10 – Non-current liabilities

	$m
Bread	792
Butter	304
Increase in defined benefit obligation (W4)	63
	1,159

Working 11 – Current liabilities

	$m
Bread	374
Butter	287
Joint operation (W6)	12
	673

Working 12 – Retained earnings

	$m
Bread	1,555
Defined benefit scheme (W4)	(72)
Share-based payment (W5)	(3·7)
Depreciation manufacturing facility (W6)	(1·9)
Joint operation (W6)	7
Goodwill impairment (W2)	(35·2)
Share post acquisition Butter ((80% x (\$482m – \$344m))	110·4
Share amortisation re Butter (80% x \$48m)	(38·4)
Share post-acquisition Jam ((100% x (\$1,272m – \$1,230m))	42
Share impairment Jam (W3)	(82)
	1,481·2

Working 13 – Non-controlling interest

	$m
Butter at acquisition (W1)	214
Post-acquisition retained earnings (20% x ($482m – $344m))	27·6
NCI share amortisation (20% x $48m)	(9·6)
Post-acquisition other components of equity (20% x ($78m – $46m))	6·4
	238·4

Working 14 – Other components of equity

	$m
Bread	164
Remeasurement component (W4)	9
Share-based payment (W5)	3·7
Revaluation gain Jam (W3)	10
Post-acquisition other components of equity (80% x ($78m – $46m))	25·6
	212·3

(b) IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* classifies a non-current asset or a disposal group as held for sale if its carrying amount will be recovered principally through a sales transaction rather than through continuing use. The standard clarifies whether the recovery of the assets would be deemed to be a sales transaction. For Bread to classify Butter as a disposal group held for sale, the following criteria must all be met as at 31 December 2017:

(i) it must be actively marketed at a price which is reasonable;

(ii) it must be available for immediate sale in its present condition, subject only to terms which are usual and customary;

(iii) the sale must be highly probable and expected to be completed by 31 December 2018;

(iv) management is committed to a plan to dispose of Jam and that it is unlikely that there would be any significant changes to the plan.

Jam is planning to continue to supply electricity to its existing customers and the sale cannot go through without regulatory approval. It would appear usual and customary for Jam to continue to supply its customers until the sale takes place. A failure to do so would impact on the reputation of Jam and the valuation of the company. The industry is also highly regulated and it would not be deemed unusual to be unable to take action to comply with regulatory conditions until an acquirer is found. It can be concluded that Jam is available for sale in its present condition as at 31 December 2017. The regulatory approval may extend the sales period beyond 31 December 2018. However, the criteria for the sale to be completed within 12 months is relaxed where the sale requires regulatory approval providing that the other conditions are met and that it is highly probable that a firm commitment to acquire Jam can be obtained within one year. Bread is confident that a purchaser will be found shortly after the year end so it appears that the directors did correctly classify Jam as held for sale at 31 December 2017.

A further issue arises as to whether Jam should be classified as a disposal group. A disposal group is defined as a group of assets and liabilities directly associated with the assets which are to be sold or transferred within a single transaction. Therefore any assets which are to be sold individually or any liabilities which are not to be transferred to the acquirer should not be included within the disposal group held for sale. Any assets which are to be sold individually would still potentially be held for sale but should be valued at the lower of cost and fair value less costs to sell on an individual basis. However, it is Bread's intention to sell its shareholding rather than any individual assets. The acquirer would also obtain all of the rights and obligations which pertain to Jam. It therefore seems appropriate to treat all of the net assets including the goodwill of Jam as a disposal group held for sale.

(c) IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* states that an entity shall only change an accounting policy if:

(i) the change is required by an IFRS or

(ii) it results in the financial statements providing reliable and more relevant information about the entity's financial position, performance or cash flows.

It might be argued that using the listed share price to value non-controlling interests at fair value might provide more relevant information. IFRS 13 *Fair Value Measurement* defines fair value as the price which would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. As Butter is listed, the share price of Butter should therefore provide a reliable estimate of the fair value of the non-controlling interest and it may be justifiable for Bread to change their accounting policy.

The share price of an entity effectively includes a premium for what investors are willing to pay for the reputation of the business and skills of the staff. By measuring the non-controlling interest at fair value, goodwill attributable to the non-controlling interest is essentially included within the goodwill on consolidation. Using the current policy of the fair value of the proportional share of the net assets at acquisition, no goodwill attributable to the non-controlling interest is consolidated since goodwill is not included within the individual net assets of the subsidiary. IFRS 3 allows an accounting policy choice, available on a transaction by transaction basis, to measure non-controlling interests (NCI) either at fair value or the NCI's proportionate share of net assets of the acquiree. However, the acquirer should carry out this measure at the acquisition date, thus precluding any retrospective adjustment for a change in accounting policy.

This would mean that if Bread had been allowed to change accounting policy under IFRS, a retrospective adjustment would be required to the goodwill and non-controlling interest of Butter which would probably lead to higher figures for both items. As non-controlling interest is included within equity, equity would consequently be higher and gearing would be lower. The change in policy would have no impact on the consolidation of Jam as it is a 100% owned subsidiary with no non-controlling interest.

Any change in policy for future acquisitions would not have an initial impact on the profitability of the group as it is only the valuation of the non-controlling interest and goodwill which is impacted upon. However, if goodwill is impaired, the valuations of goodwill under the two methods would cause a difference in the level of impairment. Under the proportional method, goodwill will need to be grossed up so that a fair comparison between the recoverable and carrying amount of the subsidiary can be obtained. Any subsequent impairment of goodwill will be split between the grossed up 'notional' goodwill and the goodwill which has been consolidated. Only the impairment attributable to the consolidated goodwill is recognised and expensed to the equity holders of Bread. Under the fair value method, there is no grossing up of goodwill but any impairment will be divided between the equity holders of Bread and the non-controlling interest. It is therefore difficult to quantify how the different policies may impact on the future profitability ratios of the group.

The directors do have a responsibility to manage the entity in a way to maximise profits for the shareholders but this should not be a consideration when deciding whether to change accounting policies. It is unethical and unacceptable to be guided by such considerations as different stakeholders of the business rely on the truth and fairness of the financial statements when making economic decisions. The deliberate manipulation of financial statements can lead to a loss of public confidence and significant harm to the reputation of the accountancy profession.

The directors appear to be willing to manipulate the financial statements and have done so on a regular basis. To change policies solely on the grounds of their financial impact would not be justifiable under IAS 8 and would therefore be an ethical issue. Continuously changing accounting policies would conflict with the principles from the ACCA Code of Ethics of objectivity, integrity and professional behaviour. It would also reduce the consistency and understandability of the financial statements. The directors should be reminded that it is their duty to produce financial statements which are a fair, transparent representation of the financial performance and position of the group.

2 (a) The measurement of financial instruments is dependent on the business model of the entity. The business model of an entity can typically be observed through the activities which an entity undertakes to achieve its business objective. The business model is a matter of fact rather than an assertion. The assessment of a business model is based on how key personnel actually manage the business, rather than management's intent for specific financial assets. It implies a more rigorous test and may potentially require entities to provide additional evidence or accumulate more historical analysis. IFRS 9 *Financial Instruments* has taken a strategic approach as the business model test requires companies to assess the nature of their business and how it allocates its financial assets. It is not as simple as establishing the nature and risk of the asset itself.

Financial assets are held at amortised cost where the entity has a business model whose objective is to hold assets to collect contractual cash flows. Having some sales activity is not necessarily inconsistent with this business model. For example, sales which are infrequent or insignificant in value or have been made as a result of an increase in credit risk may be consistent with this business model.

Financial assets classified and measured at fair value through other comprehensive income are held in a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets. Compared to a business model whose objective is to hold financial assets to collect contractual cash flows, this business model will typically involve greater frequency and volume of sales. This measurement category results in amortised cost information being provided in profit or loss and fair value information in the statement of financial position.

It appears that Spamgate has a business model whose objective is to hold assets in order to collect contractual cash flows as it seldom buys and sells financial assets but issues loans to individuals and businesses. It has only accepted the preference shares in Bosey because of the poor liquidity position of Bosey. Although Spamgate intends to sell the preference shares held in Bosey as soon as it is feasible, it does not intend to change its business model. Therefore, both the loans and the shares in Bosey should be valued at amortised cost.

The exchange of part of the loan for Bosey's shares should lead to the derecognition of that part of the loan as Spamgate's rights to that part of the loan have expired and the risks and rewards relating to that part of the loan have been extinguished.

Upon derecognition, the difference between the carrying amount of the loans and the fair value of the preference shares received should have been presented as a loss on loans instead of reducing the carrying amount of the loans, with an offsetting increase in the value of the investment in Bosey's shares. In addition, the valuation of the preference shares was not based upon their fair value as the share price used to calculate the exchange rate for the loans was three times higher than the subscription price for the unsuccessful share issue. This seems to indicate that the fair value of the shares received in the conversion was considerably lower than that used to reduce the carrying amount of the converted loans.

In addition, Spamgate is required, under IFRS 9, to recognise expected credit losses and to update the amount of expected credit losses recognised at each reporting date to reflect changes in the credit risk of financial instruments. This does not appear to have occurred.

For financial assets carried at amortised cost, a gain or loss is recognised when the financial asset is derecognised. Upon derecognition, the difference between the loans' carrying amount and the fair value of the shares received should have been recognised as a gain or loss.

(b) IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* normally requires separate provisions for onerous contracts. IAS 37 defines an onerous contract as a contract in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it. IAS 37 states that if an entity has a contract which is onerous, the present obligation under the contract shall be recognised and measured as a provision. Therefore, the contract is not an asset and should not be allocated to a CGU. IAS 37 further clarifies that before a separate provision for an onerous contract is established, an entity should recognise any impairment loss which has occurred on assets dedicated to that contract. If there are assets dedicated to an onerous contract, an entity recognises an impairment loss for those assets (or the CGU to which they belong) before a separate provision for the contract is established.

Certain intangible assets should be tested for impairment annually. If it is not possible to determine an individual asset's recoverable amount, an entity shall determine the recoverable amount of the CGU to which the asset belongs. Impairment tests are sensitive to which level assets, or groups of assets, are identified as part of the CGU. Incorrect identification of a CGU may result in assets generating significant cash inflows erroneously being grouped with assets which may not generate cash flows. This may result in impairments not being accounted for. A CGU should be determined consistently over time, unless a change is justified. Where an onerous contract is separated from the CGU, but a separate provision for the contract is not established, the financial statements will give an incomplete presentation of the total liabilities.

Therefore, the onerous contract should not be allocated to a CGU thereby changing its composition. The onerous contract provision for the gas storage contract should be recognised and an impairment loss calculated for the intangible asset in the financial reporting period to 31 May 2018.

(c) IAS 12 *Income Taxes* states that deferred tax assets for deductible temporary differences arising from investments in subsidiaries, branches and associates, and interests in joint arrangements, are only recognised to the extent that it is probable that the temporary difference will reverse against available profits.

The estimate of probable future taxable profit may include the sale of some of an entity's assets for more than their carrying amount, if there is sufficient evidence that it is probable that this will be achieved. In the case of Rooble, there is a possibility that the commercial centre may be sold for more than its carrying amount and thus can be included in the calculation of future taxable profit. However, when assessing the availability of taxable profits against which a deductible temporary difference can be utilised, Spamgate should consider whether tax law restricts the usage of those tax losses. If tax law restricts the utilisation of losses to deduction against income of a specific type, a deductible temporary difference is assessed in combination only with other deductible temporary differences of the appropriate type. Thus in this case, the tax losses can only be utilised against trading profits and not against the potential gain on the sale of the commercial centre.

In evaluating whether it will have sufficient taxable profit in future periods, Spamgate should compare the deductible temporary differences with future taxable profit which excludes tax deductions resulting from the reversal of those deductible temporary differences. It should ignore taxable amounts arising from deductible temporary differences which are expected to originate in future periods.

According to IAS 12, the existence of unused losses is a strong evidence that future taxable profit may not be available. Rooble has a history of recent losses, and therefore, it has to provide convincing evidence that sufficient taxable profit will be available to utilise the unused tax losses. However, there was no convincing evidence disclosed in the financial statements showing that the unused tax losses could be utilised by the entities in future. The country in which Rooble operates is in economic crisis including a significant decline in the currency's exchange rate and high inflation. Spamgate has no convincing evidence that this situation will reverse in the foreseeable future. The conclusion would appear to be that, based on the challenging economic environment and the fact that the construction of the commercial centre was postponed, even though there is a possibility of its sale, there is no convincing evidence that the tax losses could be utilised by Rooble in the near future. Therefore, no deferred tax asset for the unused tax losses should have been recognised.

3 **(a)** Evaluating the economic ownership of the instruments loaned to customers is quite judgemental with all factors needing to be evaluated separately. The use of 'substance over form' should always be a priority in this situation. The existing asset definition states that it is a resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity. Thus an asset is a resource rather than the inflow of economic benefits which the resource may generate. An asset must be capable of producing economic benefits, although these economic benefits need not be certain nor is there any minimum threshold before that resource meets the definition of an asset.

It is therefore important to determine whether the customer or Medsupply has the right to obtain substantially all of the economic benefits arising from use and the right to direct the use of the identified asset throughout the period. A customer has control of an asset if it has the right to operate the asset or has designed the asset in a way that predetermines its use.

The rewards associated with ownership would include the unrestricted ability to use the asset as well as to participate in any potential increases in value. Risks include the possibility of impairment, the risk of loss and usage restrictions. There are several factors which will help to determine who enjoys the economic benefits. On the return of the instruments, they are disposed of as clinical waste and, hence, it would appear that the instruments have no value on return. Additionally, the instruments are nearly always returned at the end of their useful life and hence the economic benefit has remained with the hospital throughout the life of the instrument. It appears from the above discussion that the hospital has the right to obtain substantially all the economic benefits and therefore no assets should appear in the financial statements of Medsupply. This conclusion is despite the fact that Medsupply retains the legal ownership.

Lessors are required to apply IFRS 15 *Revenue from Contracts with Customers* to allocate the consideration in the contract. Where a contract has multiple performance obligations, an entity will allocate the transaction price to the performance obligations in the contract by reference to their relative standalone selling prices. Thus it could be argued that the contract of sale contains a lease from the viewpoint of the instruments and that the transaction price should be split accordingly between the value of the devices and the instrumentation.

The costs incurred to fulfil a contract are recognised as an asset if and only if all of the following criteria are met:

– the costs relate directly to a contract (or a specific anticipated contract);

– the costs generate or enhance resources of the entity which will be used in satisfying performance obligations in the future; and

– the costs are expected to be recovered.

Thus utilising the above criteria from IFRS 15, it would indicate that the cost of the instrumentation should not be shown as an asset of Medsupply as it will not be recovered. The instruments form an integral part of an overall surgical process and are part of a multiple-component arrangement between Medsupply and the hospital. However, in this case, the instruments are simply a cost of sale. The instruments should be initially recorded at their acquisition and/or production cost in accordance with IAS 2 *Inventory*. Subsequent to initial recognition, the instruments should be measured at the lower of cost and net realisable value and when the instrument is loaned to the hospital, the manufacturer should reduce its inventory and recognise costs of sales accordingly, as Medsupply is not receiving proceeds for the usage of the instrument.

(b) IAS 38 *Intangible Assets* states that the three attributes to intangible assets are identifiability, control and future economic benefits. In addition, the cost of the intangible asset should be capable of reliable measurement. Development costs are capitalised only after the technical and commercial feasibility of the asset have been established. The entity must intend and be able to complete the intangible asset and either use it or sell it and be able to demonstrate how the asset will generate future economic benefits. In principle, the above criteria may appear to be satisfied in the case of the costs of adapting the medical equipment imported by Medsupply. However, only the costs incurred in developing the initial know-how of $3 million may be capitalised as these are the costs of establishing the technical and commercial feasibility of the equipment. The costs of adapting each piece of equipment of $50,000 are simply production costs to be included in costs of sales and, if the equipment is not sold, they should be included in the inventory valuation of the equipment.

IAS 37 *Provisions, Contingent liabilities and Contingent Assets* requires that a provision be recognised if the following conditions are met:

(i) present obligation (legal or constructive) as a result of a past event;
(ii) probable outflow of economic resources to settle the obligation; and
(iii) the amount of the obligation can be estimated reliably.

An outflow of economic resources is deemed probable when the outflow of resources is more likely than not to occur. In order for an estimate of the amount of the obligation to be reliable, it is sufficient if a range of probable outcomes can be determined. The amount recognised as provision should be the best estimate of the expenditure which an entity would rationally pay to settle. Medsupply's lawyers feel that the court could conclude that the patent claim is not valid. However, Medsupply has offered $7 million to settle both claims without going to court and therefore this implies that Medsupply believes that it is more likely than not that a present obligation exists and this is the result of a past event. The amount of the provision may not correspond to the amount which has been offered to Cosine as there is no certainty that Cosine will accept the offer. Therefore, as it is difficult to determine the amount of the provision within a range of probable outcomes, IAS 37 states that where a continuous range of possible outcomes exists, and each point in that ranges is as likely as any other, the mid-point of the range should be used. Thus, Medsupply should recognise a provision of $10 million in its financial statements at 31 May 2018 and disclose the uncertainties relating to the amount or timing of these cash outflows.

(c) The International Accounting Standards Board's (IASB's) *Conceptual Framework* states that expenses are recognised when a decrease in future economic benefits related to a decrease in an asset or an increase of a liability has arisen which can be measured reliably. This means, in effect, that recognition of expenses occurs simultaneously with the recognition of an increase in liabilities or a decrease in assets. Essentially, this recognition should occur when the related goods or services are consumed, irrespective of the timing of funds being paid.

IAS 38 *Intangible Assets* provides guidance on internally generated intangible assets which are recognised only if, amongst other criteria, the technical feasibility of a development project can be demonstrated.

Initially, Medsupply should record the pre-payment to CUT as an asset. Then, as the research services are performed by CUT, Medsupply must continue to determine if the criteria for the capitalisation of an intangible asset have been met. The services being performed by CUT appear to be of a research nature and not development work as CUT has been contracted to aid and support the development of knowledge in the field of tropical disease. Additionally, CUT provides advice on the early development of research proposals and design. Thus almost certainly the costs incurred will be classed as research expenditure. Therefore, Medsupply should expense the related costs as services rendered.

The *Framework* states that income is recognised when an increase in future economic benefits related to an increase in an asset or a decrease of a liability has arisen which can be measured reliably. IFRS 15 *Revenue from Contracts with Customers* states that entities must evaluate whether non-refundable upfront fees relate to the transfer of a good or service. In many situations, an upfront fee represents an advance payment for future goods or services. Medsupply will need to assess if the non-refundable fee relates to a separate performance obligation. The upfront fee appears to represent an advance payment for future goods or services and it appears that these services will not commence for at least four months as that is the date when the contract with CUT commences. Such fees would be recognised as revenue only when those future goods or services are provided, that is in four months' time.

4 (a) (i) The *Conceptual Framework* sets out the following definitions of assets and liabilities:

(a) An asset is a resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity.

(b) A liability is a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits.

The definitions use the word 'expected' which indicates that the inflows and outflows do not need to be completely certain before an asset or liability exists. There is no quantification of the level of inflows and outflows which are 'expected'. There are also additional criteria in the *Conceptual Framework* which must be met before assets and liabilities can be recognised. An item which meets the definition of an element should be recognised if:

(a) it is probable that any future economic benefit associated with the item will flow to or from the entity; and

(b) the item has a cost or value which can be measured with reliability.

Probability is used in the recognition criteria to refer to the degree of uncertainty that the future economic benefits associated with the item will flow to or from the entity. This principle is consistent with the uncertainty which relates to the environment in which any entity operates. However, the level of certainty required before elements are recognised in the financial statements is not defined but left to individual International Financial Reporting Standards (IFRS).

(ii) IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* states that one of the conditions for recognising a provision is that payment must be probable which itself is defined as 'more likely than not'. IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* states that one of the conditions which must be met for an asset (or 'disposal group') to be classified as held for sale is that the sale is 'highly probable', within 12 months of classification as held for sale. IAS 37 states that its interpretation of probable does not necessarily apply to other standards. IFRS 5 does not include this caveat. In practice, the term probable in IFRS has been interpreted as meaning something other than 'more likely than not'.

IFRSs use a variety of terms to indicate different levels of uncertainty, for the purposes of definition, recognition, classification and disclosure. For example, IAS 37 states that entities should not recognise contingent liabilities but should disclose them, unless the possibility of an outflow of economic resources is remote. Additionally, IAS 37 states that contingent assets should not be recognised but should be disclosed where an inflow of economic benefits is probable. When the realisation of income is virtually certain, then the related asset is not a contingent asset and its recognition is appropriate.

It can be argued that given the range of possible probability-thresholds, and their lack of precise definition, a more consistent and clearer guidance on the threshold level is needed.

(b) The *Conceptual Framework* states that information is material if omitting it or misstating it could influence decisions which users make on the basis of financial information about a specific reporting entity. Materiality is an entity-specific judgement based upon the relevance, nature and magnitude of the financial statement items involved. IAS 1 *Presentation of Financial Statements* states that the assessment of materiality should take into account how users could reasonably be expected to be influenced in making economic decisions on the basis of financial statements. The use of the principles behind the concept of materiality should ensure that the financial statements are an effective and understandable summary of the entity's internal accounting records. Information in the financial statements should be summarised and aggregated in a clear and helpful manner without an excessive amount of immaterial information being disclosed or material information being omitted.

For instance, a common issue is whether an entity needs to disaggregate certain line items, for example, revenue, into categories on the face of the primary financial statements or if provision of this information in the notes is sufficient. It is important to determine the appropriate level of aggregation on the face of the primary financial statements. In certain industries, the materiality assessment may rely on different quantitative materiality thresholds depending upon the primary financial statement. Similarly, certain elements of the primary financial statements or the notes may attract more attention from the users of financial statements for certain industries. For instance, due to regulatory requirements, liquidity and liquidity ratios are considered more important in the financial statements of a bank than in the financial statements of an insurance company. An entity would need to consider such industry-specific aspects when assessing materiality. The International Accounting Standards Board (IASB) feels that the poor application of materiality contributes to too much irrelevant information in financial statements and not enough relevant information. In the light of this feedback, the IASB decided to undertake a project on materiality by issuing an Exposure Draft of an IFRS *Practice Statement Application of Materiality to Financial Statements*. Examples which are commonly cited as poor application of materiality, that is where judgement may not have been used appropriately, include:

(i) use of the disclosure requirements as a checklist; and

(ii) describing accounting policies in financial statements using words directly from IFRS, or copying note disclosures from illustrative financial statements without making the information entity-specific.

A practising accountant may use similar principles as preparers do when making judgements in applying the concept of materiality. However, practising accountants may also apply the concept of materiality for different purposes, for example, audit purposes. It would not be appropriate for preparers to rely on materiality thresholds used by practising accountants when making decisions about the application of materiality to the financial statements. However, irrespective of how materiality is used by preparers and accountants, both are focused on the same fundamental issues, that is what financial information will impact the decisions of users of the financial statements and whether or not the financial statements are free of material misstatement and in the end provide a fair presentation.

(c) Lamyard will need to assess the full effect of the jurisdiction exiting the agreement. They will need to provide disclosures on the entity's exposure to risks (for example, financial, operational and strategic risks), their expected impact and the uncertainties which might affect the entity's activities and how they are going to manage and mitigate those risks. In this respect, Lamyard should provide high quality narrative information which supplements the financial statements.

Particular attention should be given to disclosures related to liquidity risks or debt repayments due to breaches of covenants. Lamyard should consider the need to provide the disclosures related to potential impairment of assets, as well as the disclosures required by IFRS 7 *Financial Instruments: Disclosures*. Under IAS 1 *Presentation of Financial Statements*, an entity should disclose information about the assumptions it makes about the future, and other major sources of estimation uncertainty at the end of the reporting period, which have a significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities within the next financial year.

There is a potential reduction of estimated cash flows, changes in the supply chain costs or the volatility of the financial markets and exchange currency rates because of the exiting from the agreement. The local currency has already suffered a devaluation. Thus, Lamyard should assess the assumptions used in the valuation of assets and liabilities and, where applicable, to recognise impairment losses. Lamyard should assess if relevant triggers for the recognition of impairment losses in financial assets are met and if the recoverable amounts determined in accordance with IAS 36 *Impairment of Assets* decrease significantly. Assets measured at fair value under IFRS 13 *Fair Value Measurement* or fair value of plan assets and defined benefit obligations under IAS 19 *Employee Benefits* will need review.

IAS 21 *The Effects of Changes in Foreign Exchange Rates* specifies only that the amount of exchange differences should be disclosed. When making judgements about materiality, the entity should assess whether the loss should be reported separately from the other exchange differences. The fact that a large loss was incurred relative to the other transactions, and that the loss was from speculative activity, suggests that aggregating these exchange differences would result in a loss of material information. Information which could influence users' opinions of management's stewardship would be lost through aggregation. In some jurisdictions, local corporate governance requirements prohibit speculative activities unless closely monitored and therefore disclosure of the information would be critical. However, in those jurisdictions where speculation is not prohibited, it could be argued that the reason for a large loss does not impact on the assessment of whether it is material or not as the absolute amount is material in itself when compared to the total of which it forms part.

			Marks
1	**(a)**	Property plant and equipment	1
		Intangibles	1
		Goodwill	3
		Current assets	1
		Assets held for sale	2
		Non-current liabilities	1
		Current liabilities	1
		Impairment of Butter	3
		Impairment of Jam	5
		Pension	3
		Share-based payment	2
		Retained earnings	7
		Non-controlling interests	2
		Other components of equity	3
			35
	(b)	1 mark per comment up to maximum	6
	(c)	1 mark per point (max 5 accounting treatment ratios/ethics max 4)	9
			50
2	**(a)**	1 mark per point up to maximum	9
	(b)	1 mark per point up to maximum	6
	(c)	1 mark per point up to maximum	8
	Professional marks		2
			25
3	**(a)**	1 mark per point up to maximum	8
	(b)	1 mark per point up to maximum	9
	(c)	1 mark per point up to maximum	6
	Professional marks		2
			25
4	**(a)**	**(i)** 1 mark per point up to maximum	5
		(ii) 1 mark per point up to maximum	5
	(b)	1 mark per point up to maximum	6
	(c)	1 mark per point up to maximum	7
	Professional marks		2
			25