Test your understanding answers

Test your understanding 1 – Starling

The financial instrument should have been classified as a financial liability because it contains a contractual obligation to transfer cash.

This means that Starling's equity is overstated and its liabilities are understated. The error will improve the gearing ratio, which may lead investors to underestimate Starling's financial risk.

Dividends on equity instruments are charged to retained earnings, whereas interest on financial liabilities is charged to finance costs in the statement of profit or loss. This means that Starling's profits and earnings per share will also be overstated.

Test your understanding 2 – Coe

Share options

This is an equity-settled share-based payment. A remuneration expense should be recognised in profit or loss over the three year vesting period. This should be based on the fair value of the options at the grant date ($6) and the number of options expected to vest. The other side of the accounting entry is recognised in equity.

The expense is calculated as follows:

(1,000 – 50 – 80) × 500 × $6 × 1/3 = $0.9 million.

The adjusting entry is:

Dr Profit or loss	$0.9m
Cr Equity	$0.9m

This adjustment reduces the profit attributable to the equity shareholders of the group by $0.9 million and so will reduce basic earnings per share and diluted earnings per share.

The share options represent a commitment to issue equity shares in the future at an amount that is below the average share price. These are therefore a dilutive instrument, which will cause a further reduction in diluted earnings per share.

Land

In accordance with IFRS 13 *Fair Value Measurement*, the selling price of similar plots of land would constitute a level 2 input to the fair value hierarchy. It is unlikely that level 1 inputs exist. However, Coe should assess whether adjustments are required to the $5 million price to take into account the location and condition of its specific asset.

Assuming no adjustments are required to the valuation, the land should be revalued to its fair value of $5 million with a gain of $1 million recognised in other comprehensive income.

Dr Property, plant and equipment	$1m
Cr Other comprehensive income	$1m

In the statement of other comprehensive income, this gain will be presented as an item that will not be reclassified to profit or loss in the future.

This adjustment has no impact on profit. As such, it has no impact on basic and diluted earnings per share.

Financial asset

The loan is a financial asset because it gives Crace a contractual right to receive cash.

The financial asset should have been initially measured at fair value. Because the loan is interest-free, the $3 million price does not represent the asset's fair value. The fair value should be determined by discounting the future cash flows to present value using a market rate of interest:

$\$3m \times 1/1.05^3 = \$2.6$ million.

The financial asset must be written down to $2.6 million. The $0.4 million loss is expensed to profit or loss:

Dr Profit or loss	$0.4m
Cr Financial asset	$0.4m

This adjustment reduces consolidated profit by $0.4 million. Of this, $0.3 million ($0.4m × 75%) is attributable to the equity shareholders of the group and the remaining $0.1 million is attributable to the non-controlling interest.

Basic and diluted earnings per share are calculated based on profit attributable to the equity shareholders of the group. As such, these ratios will deteriorate once the error is corrected.

Test your understanding 3 – Impact of policy choices

	Entity A	Entity B
Operating profit margin	18.2%	4.5%
Return on capital employed	16.7%	2.4%
Gearing (debt/debt + equity)	41.7%	23.8%

As a result of the upwards revaluation, Entity B has charged more depreciation to profit or loss than Entity A. This means that Entity B has lower profits and a lower operating profit margin.

Entity B's upwards revaluation has increased equity in the statement of financial position. This reduces its ROCE, making Entity B appear less efficient than entity A. However it also means that Entity B's gearing is lower than Entity A's, making it seem like a less risky investment.

Test your understanding 4 – Tuyet

High level analysis

Tuyet has generated a cash surplus during the year. However, this is relatively small compared to the size of its outgoings. Moreover, Tuyet is in a negative overall cash position (i.e. it has overdrafts). This will lead to increased interest payments. There is also a risk that the overdraft could be withdrawn, placing Tuyet at considerable risk.

Operating cash flows

Tuyet has made an operating profit of $40 million ($35 + $5m) but it has only generated cash from operations of $18 million. This suggests that Tuyet’s profits are relatively low quality and are not backed up by cash.

There have been substantial increases in the level of inventories year-on-year. This is having a negative impact on Tuyet’s cash flows. This might be a response to bulk orders. Alternatively, it could be due to inefficient inventory management, exposing Tuyet to the risk of inventory obsolescence.

The increase in receivables suggests that customers are paying Tuyet more slowly. It would seem that Tuyet is compensating for this by taking longer to pay its own suppliers. This could cause Tuyet problems – particularly if its suppliers tighten or remove credit terms.

After making mandatory interest and tax payments, there is only a small cash surplus of $3 million from operating activities. Tuyet's trading operations are not generating enough cash to invest in PPE or to repay loans and so funds have been obtained from other less-sustainable sources.

Investing cash flows

Tuyet has invested in PPE during the year. This suggests that productive capacity can be maintained or improved.

However, it should be noted that substantial receipts have been generated by selling PPE – these cash flows will not recur year-after-year. Without these receipts, Tuyet would have recorded an overall decrease in cash and cash equivalents.

The high level of PPE disposals raises concerns: does Tuyet have idle assets (which may require impairment), or is it being forced into disposing of key assets in order to raise cash?

Financing cash flows

Tuyet has repaid some of its loan this year. As a result interest payments should reduce in the future, freeing up operating cash flows.

However, the loan repayment was only possible as a result of a share issue. Tuyet cannot perform share issues indefinitely. Therefore, higher operating cash flows are required if Tuyet is to meet its future loan repayments.

Tuyet has not paid a dividend this year, no doubt due to its poor cash position. This may deter potential and current investors from providing further resources.

Test your understanding 5 – Hutton

Depreciation and amortisation are judgemental, non-cash expenses. However, excluding them from underlying profit ignores the fact that the entity's non-current assets will need to be replaced or enhanced in the future.

The impairment of a brand suggests that the business outlook may be weaker than expected. It also indicates that management over-paid for the brand. Adding back this expense when calculating underlying profit diminishes its significance when assessing the past decisions of management and also when predicting Hutton's future performance.

Foreign exchange differences on monetary items can be volatile, and potentially distort an entity's performance profile. However, many monetary items, such as receivables and payables, are short-term in nature and so represent gains and losses that will be realised in the near future. It would seem that Hutton will be receiving less units of its functional currency (or paying more units) than originally expected when the overseas transactions are settled and so it seems odd to exclude these losses from underlying profit.

Fair value gains on financial assets measured at fair value through profit or loss are volatile and may make it difficult to compare an entity's performance year-on-year. However, these financial assets are likely to be sold in the short-term and so the gains (or losses) will be realised shortly. They are also unlikely to be one-off items – entities that trade material quantities of financial assets will probably enter into similar transactions on a regular basis.

Overall, it looks like Hutton is trying to disguise a weak performance – particularly as the APM has turned a loss before tax into a profit. This could be misleading, particularly if the APM is presented with prominence.

However, to Hutton's credit, it discloses the calculation behind the APM, thus allowing users to reconcile it to the figures in the financial statements. This will enable them to draw their own conclusions about the adequacy and usefulness of this APM.

Test your understanding 6 – Lorenzo

Profits

Lorenzo's profit decline year-on-year will be concerning to investors. However, the non-financial information presented in the integrated report paints a more optimistic picture of the entity's future prospects.

Faults

A decline in the number of faults in Lorenzo's products will reduce future repair costs, increasing profits. Fewer faults will improve customer satisfaction. This may generate stronger brand loyalty, making it more likely that customers will make repeat purchases.

Helpline

The reduction in helpline waiting times may be due to the reduction in the number of product faults or, potentially, to investment in the customer services department. Whatever the reason, this is likely to have a positive impact on customer perception which may, once again, improve brand loyalty.

Staff turnover

Reduced staff turnover means that staff experience is being retained in the business. This might help to reduce recruitment and training costs in the future. Moreover, experienced staff will probably perform at a higher level than inexperienced staff. In fact, this may partly explain the improvement in fault levels and customer helpline waiting times. Reduced staff turnover could also have other benefits – more experienced staff might develop more innovative products.

Summary and further information

In conclusion, the non-financial information in the Integrated Report provides an important insight into Lorenzo's future prospects. Nonetheless, it would be useful to compare these performance measures to other entities in the same sector. Furthermore, some investors may question the reliability of these disclosures unless assurance is provided by an assurance practitioner.

Test your understanding 7 – Environmental impact

The following are advantages that may arise when an entity discloses its impact on the environment:

- Traditional financial reporting makes limited reference to environmental issues. Filling this information gap may meet the needs of certain stakeholders.
- Providing more information to stakeholders increases an entity's accountability, as it is more difficult to conceal information.
- Reports that demonstrate an entity is managing environmental risks will improve perception of its sustainability and therefore its prospects in the medium to long-term.
- Good quality reporting may make an entity more attractive to investors, particularly if they can see that risks to sustainability are being managed.
- Non-financial reporting is increasingly regarded as best practice and may improve an entity's corporate image.
- 'Green' consumers are more likely to buy from entities that are open and transparent about their environmental impact.
- Entities are increasingly concerned about the ethical stance of other entities within their supply chain. Disclosing quality environmental information may make an entity a more attractive supplier.
- Environmental reporting might increase community support for an entity.
- The process of evaluating environmental performance might highlight inefficiencies in operating activities, enabling management to improve the entity's systems.

Test your understanding 8 – AA

An integrated report might highlight a number of positive issues about AA:

- AA's financial capital has increased as a result of its profitable current business activities.
- Financial capital has increased due to the receipt of government grants and this will help AA to repay its debts in the short and also, potentially, the medium term.
- AA's has a positive impact on social capital by helping low income families to buy essential items of clothing. This is likely to foster brand loyalty from these customers, as well as generating good publicity. This may lead to a further increase in financial capital in the future.

However, it could be argued that the AA business model will not create value in the long-term. An integrated report might refer to the following issues:

- The government grants may not continue indefinitely. This could be due to government budget cuts, increasing competition or, perhaps, as a result of ongoing quality issues with AA products.
- AA does not invest highly in human capital. Unskilled and untrained staff are unlikely to foster brand loyalty and could lead to a loss of custom over time.
- AA uses cheap labour from overseas. Although this is likely to increase financial capital, it may lead to a net decrease in other capitals
  - AA may be criticised for not investing in local communities, or for exploiting overseas workers. By not investing in human capital there may also be a negative impact on social and relationship capital.
  - AA's recognition of the need to increasingly monitor its suppliers indicates that current economic benefits may not be sustainable in the longer-term.
- Purchasing goods from overseas will increase AA's carbon footprint. Moreover, AA does not widely recycle. Its activities thus place an overall drain on natural capital and this may deter some investors and consumers.
- A focus on high street expansion may leave AA vulnerable to online competitors, who will be able to offer the same products more cheaply. AA's lack of investment in staff may compound this because the retail stores are unlikely to offer a greater experience or level of service than can be obtained online. The current business model may therefore not be resilient in the medium or long term.

Summary

AA's business model is currently profitable. Such information could be obtained from the historical financial statements. However, an integrated report that looks at value creation and stability in the medium and longer term may offer a more pessimistic outlook. Banks are more likely to invest in companies who have sustainable business models and therefore integrated reports will help them to make stronger investment decisions. Other investors, such as potential or current shareholders, would also be able to make more informed decisions.

Producing an Integrated report is not mandatory. Businesses which have a detrimental net impact on capitals (particularly non-financial capitals) are unlikely to voluntarily produce an integrated report. In contrast, companies who create value in sustainable ways are more likely to want to disclose this to users. However, if the production of an integrated report was mandatory, then it might motivate a company like AA to shift its focus from increasing short term financial capital to the generation of an array of capitals over the medium and long-term.

Chapter

23

Current issues

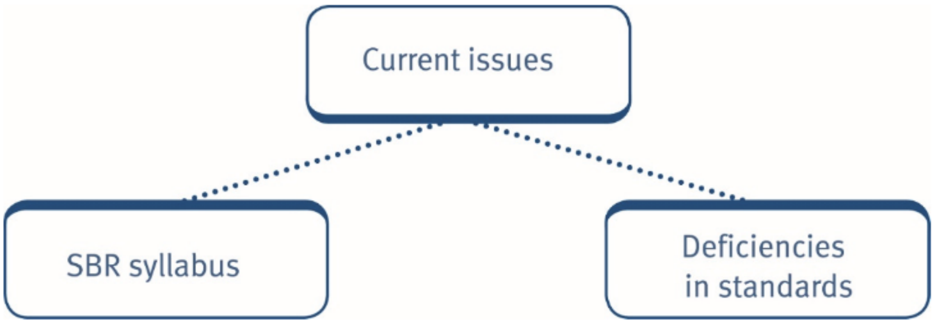
Chapter learning objectives

Upon completion of this chapter you will be able to:

- Identify issues and deficiencies which have led to proposed changes to an accounting standard
- Discuss the impact of current issues in corporate reporting. This may be tested by requiring the application of one or several existing standards to an accounting issue. The following examples are relevant:
  - accounting for digital assets
  - accounting for the effects of a natural disaster
  - climate change
  - a global event
  - going concern assessments
  - materiality in the context of financial reporting
  - management commentary
- Discuss developments in devising a structure for corporate reporting that addresses the needs of stakeholders.
- Discuss developments in corporate reporting related to sustainability reporting and sustainability standards.

PER

One of the PER performance objectives (PO2) is stakeholder relationship management. You manage stakeholder expectations and needs, developing and maintaining productive business relationships. You listen to and engage stakeholders effectively and communicate the right information to them when they need it. Working through this chapter should help you understand how to demonstrate that objective.



1 Key current issues

Current syllabus

The SBR syllabus and list of examinable documents identifies the following current issues:

- accounting for digital assets
- accounting for the effects of a natural disaster
- climate change
- a global event
- going concern assessments
- materiality
- management commentary
- developments in corporate reporting related to sustainability reporting and sustainability standards.

Progression

You will not have studied this topic before. It is a core area of the SBR syllabus.

2 Accounting for digital assets

This section discusses the accounting treatment of two issues: cryptocurrency and initial coin offerings.

Cryptocurrency

Cryptocurrencies are virtual currencies that provide the holder with various rights. They are not issued by a central authority and so exist outside of governmental control. Cryptocurrencies, such as the Bitcoin, can be used to purchase some goods and services although they are not yet widely accepted. The market value is extremely volatile and some investors make high returns through short-term trade.

The accounting treatment of cryptocurrency is not clear cut.

Cryptocurrencies do not constitute 'cash' because they cannot be readily exchanged for goods and services. Moreover, they do not qualify as a 'cash equivalent' (in accordance with IAS 7 *Statement of Cash Flows*) because they are subject to a significant risk of a change in value.

An investment in cryptocurrency does not represent an investment in the equity of another entity or a contractual right to receive cash, and so does not meet the definition of a financial asset as per IAS 32 *Financial Instruments: Presentation*.

The most applicable accounting standard would appear to be IAS 38 *Intangible Assets* because cryptocurrency is an identifiable non-monetary asset without physical substance.

Although cryptocurrencies most likely fall within the scope of IAS 38, the measurement models in that standard do not seem appropriate. The fair value of cryptocurrency is volatile so a cost based measure is unlikely to provide relevant information. The revaluation model in IAS 38 initially seems more appropriate, but this requires gains on remeasurement to fair value to be presented in other comprehensive income. Many entities invest in cryptocurrencies to benefit from short-term changes in fair value and gains or losses on short-term investments are normally recorded in profit or loss (e.g. assets inside the scope of IFRS 9 *Financial Instruments*).

As can be seen, the accounting treatment of cryptocurrencies is not straight-forward. In the absence of an appropriate accounting standard, preparers of financial statements should refer to the principles in existing IFRS Standards as well as the *Conceptual Framework* in order to develop an accounting policy.

Initial coin offerings

Initial coin offerings (ICO) are a method of raising finance through cryptographic assets. Investors (sometimes called supporters) buy into the ICO and receive tokens in exchange. This is similar to the approach used in crowdfunding, with ICOs originally being used by tech entrepreneurs.

The tokens received might entitle the holder to cryptocurrencies, or they might be utility tokens (which provide users with access to a product or service) or security tokens (which might provide an economic stake in an entity, or the right to receive cash or assets in the future). Tokens can become valuable and can often be traded on a crypto exchange.

ICOs are largely unregulated, allowing companies to bypass the regulated and lengthy process of raising finance through a bank.

When an entity raises funds in this way, it will record the receipt of an asset as the debit entry (this might be cash or a different cryptocurrency, such as Bitcoins). However, the key consideration is determining the credit entry that should be posted. This is dependent on the nature of the tokens issued. Possibilities include:

- **Financial liability** – the reporting entity might be contractually obligated to deliver cash or another financial asset to the holder of the tokens.
- **Equity** – the holder of the token issued through the ICO may be entitled to payments out of distributable reserves. This would qualify as equity if the reporting entity was under no contractual obligation to deliver cash or another financial asset.
- **Revenue** – this might apply if the recipient was a customer and if a 'contract' (per IFRS 15 *Revenue from Contracts with Customers*) exists.
- **None of the above** – if there is a legal or constructive obligation to the subscriber then a provision should be recognised in accordance with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets.* If an entity determines that no specific IFRS Standard applies to its issued tokens, then it should refer to IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* in order to develop an appropriate accounting policy. This will require reference to the *Conceptual Framework*.

Similar accounting dilemmas exist with Security Token Offerings where investors are issued with tokens representing a stake in an external asset, such as shares or bonds.

3 Accounting for the effects of a natural disaster

Natural disasters

Natural disasters include volcanic eruptions, earthquakes, droughts, tsunamis, floods, hurricanes and pandemics. Natural disasters devastate communities, and the process of recovery can take years. Companies that operate in areas effected by natural disasters will also have to consider the financial reporting consequences. Some of these are considered below.

Impairments

A natural disaster is likely to trigger an impairment review – particularly in relation to property, plant and equipment (PPE). This is because, in accordance with IAS 36 *Impairment of Assets*, there are likely to be indicators of impairment. This may be because individual assets are damaged, or it may be because the economic consequences of the disaster trigger a decline in customer demand. If PPE is destroyed, then it should be derecognised rather than impaired.

In line with IFRS 9 *Financial Instruments,* entities that lend money will need to assess whether credit risk associated with the financial asset has increased significantly. A natural disaster is likely to lead to a higher default rate, so some financial assets will become credit-impaired.

Natural disasters may lead to inventory damage. Alternatively, the economic consequences of the disaster may mean that inventory must be sold at a reduced price. As per IAS 2 *Inventories*, some inventory may need to be remeasured from its cost to its net realisable value.

Insurance

It is likely that entities affected by natural disasters will need to account for insurance claims. This can be a difficult area because of uncertainty regarding the nature of the claim, the type of coverage provided by the insurance, and the timing and amount of any proceeds recoverable.

IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* only allows the recognition of an asset from an insurance claim if receipt is virtually certain. This is a high threshold of probability and so recognition is unlikely. However, if an insurance pay-out is deemed probable then a contingent asset can be disclosed.

Additional liabilities

As a result of a natural disaster, an entity may decide sell or terminate a line of business, or to save costs by reducing employee headcount. In accordance with IAS 37, a provision will be recognised if there is a present obligation from a past event and an outflow of economic benefits is probable. An obligation only exists if a restructuring plan has been implemented or if a detailed plan has been publicly announced. When measuring the provision, only the direct costs from the restructuring, such as employee redundancies, should be included.

Provisions may be required if there is an obligation to repair environmental damage. Moreover, decommissioning provisions (when an entity is obliged to decommission an asset at the end of its life and restore the land) will require review because the natural disaster may alter the timing or amount of the required cash flows.

Deferred tax

A natural disaster may affect a company's estimate of future taxable profits. In accordance with IAS 12 *Income Taxes,* this may mean that deferred tax assets cannot be recognised.

Going concern

Natural disasters will lead to changes in the economic environment, as well as business interruption and additional costs. It may be that bank loan covenants are breached. If there are material uncertainties relating to going concern, then these must be disclosed in accordance with IAS 1 *Presentation of Financial Statements*. If the going concern assumption is not appropriate then the financial statements must be prepared on an alternative basis and this fact must be disclosed.

4 Accounting for climate change, global events and going concern assessments

Just like with natural disasters, there is no single IFRS standard which addresses these issues. However, companies must consider climate-related matters and global events when the effect is material on the financial statements.

Take a look at the question below, which will allow you to apply your knowledge to a particular global event – a pandemic.

Test your understanding 1 – Middleshop

Middleshop operates in the fashion retail industry and has a year end of 31 December 20X1. It owns fifteen stores all located in one country (and accounted for using the cost model in IAS 16 *Property, Plant and Equipment).* Due to an international pandemic, the government of the country in which Middleshop operates required all non-essential retail and hospitality outlets to close for several months during 20X1. It is anticipated that further closures will be mandated throughout 20X2 until an effective vaccine is developed and rolled out amongst the population.

The pandemic has had a negative impact on the fashion industry. Demand for new clothing has declined due to national and localised lockdowns as well as limits on intra-household socialising and the increased uptake of home-working. Moreover, the full economic impact of the pandemic has yet to be realised with unemployment expected to rise significantly throughout 20X2.

Middleshop's stores were open for trading during December 20X1, normally the busiest month of the year. However, high street footfall was far lower than previous years with many consumers reducing expenditure or choosing to shop online. Middleshop sells online through its website but the functionality is poor and customer uptake is low. The website is recognised as an intangible asset and is being amortised over a remaining life of five years.

The directors of Middleshop are considering closing some larger stores in 20X2 although, as at 31 December 20X1, no firm plans had been drawn up. A significant operating loss is expected in 20X2. The directors wish to provide for potential redundancy costs and the future operating loss in the financial statements for the year ended 31 December 20X1.

Middleshop has bank loans, some of which are repayable within 12 months of the reporting date.

Required:

Discuss the financial reporting implications of the above in Middleshop's financial statements for the year ended 31 December 20X1.

5 Materiality

Background

Materiality as a concept is used widely in financial reporting. However, the Board accepts that further guidance is needed on how to apply it to the preparation and interpretation of financial statements.

The Practice Statement

The Board have issued a Practice Statement called *Making Materiality Judgements*. This provides non-mandatory guidance that may help preparers of financial statements when applying IFRS Standards.

The key contents of the Practice Statement are summarised below.

Definitions and objectives

Information is material if omitting, misstating or obscuring it would influence the economic decisions of financial statement users.

The objective of financial statements is to provide useful information about the reporting entity to existing and potential investors, lenders and other creditors to help them make decisions about providing resources to that entity. This requires that the preparers of the financial information make materiality judgements.

When assessing whether information is material, an entity should consider:

- Quantitative factors – measures of revenue, profit, assets, and cash flows
- Qualitative factors – related party transactions, unusual transactions, geography, and wider economic uncertainty.

Materiality judgements are relevant to recognition, measurement, presentation and disclosure decisions.

Recognition and measurement

An entity only needs to apply the recognition and measurement criteria in an IFRS Standard when the effects are material.

e.g

Recognition criteria

An entity buys fixtures and fittings that are in the scope of IAS 16 *Property, Plant and Equipment* (PPE). IAS 16 stipulates that the cost of an item of PPE should be recognised as an asset. However, to save time, the entity decides that expenditure on fixtures and fittings costing below $1,000 should be written off to profit or loss. As long as the impact of this policy is not material, the entity's financial statements will still comply with IAS 16.

Presentation and disclosure

An entity only needs to apply the disclosure requirements in an IFRS Standard if the resulting information is material.

The entity may need to provide additional information, not required by an IFRS Standard, if necessary to help financial statement users understand the financial impact of its transactions during the period.

Disclosure requirements
IAS 16 requires disclosure of an entity's contractual commitments to purchase PPE. If such commitments are immaterial, then the disclosure is not required.

When organising information, entities should:

- Emphasise material matters
- Ensure material information is not obscured by immaterial information
- Ensure information is entity-specific
- Aim for simplicity and conciseness without omitting material detail
- Ensure formats are appropriate and understandable (e.g. tables, lists, narrative)
- Provide comparable information
- Avoid duplication.

Users

Materiality judgements must be based on the needs of the primary users of financial statements.

The primary users are **current and potential** investors, lenders and creditors.

Financial statements cannot meet all of the information needs of the primary users. However, preparers of financial statements should aim to meet common information needs for each group of primary users (e.g. investors, lenders, other creditors).

Users
Fifty investors each hold 2 per cent of an entity's ordinary shares. One of these investors is interested in information about the entity's expenditure in France because that investor operates other businesses in that country. In making materiality judgements, the entity does not consider the specific information needs of that single investor if expenditure in France is immaterial information for its primary users as a group.

Process

The Board recommends a systematic process when making materiality judgements:

Step 1
Identify information that could be material

↓

Step 2
Assess whether that information is material

↓

Step 3
Organise the information in draft financial statements

↓

Step 4
Review the draft financial statements

6 Management commentary

Purpose of Management Commentary

The IFRS Practice Statement *Management Commentary* provides a framework for the preparation and presentation of management commentary on a set of financial statements.

Management commentary provides users with more context through which to interpret the financial position, financial performance and cash flows of an entity.

It is not mandatory for entities to produce a management commentary.

Framework for presentation of management commentary

The purpose of a management commentary is:

- to provide management's assessment of the entity's performance, position and progress
- to supplement information presented in the financial statements, and
- to explain the factors that might impact performance and position in the future.

This means that the management commentary should include information which is forward-looking.

Information included in management commentary should possess the qualitative characteristics of useful information (as outlined in the *Conceptual Framework*). In other words, the information should be relevant, faithfully represented, comparable, timely, verifiable and understandable.

Elements of management commentary

Management commentary should include information that is essential to an understanding of:

- the nature of the business
- management's objectives and strategies
- the entity's resources, risks and relationships
- the key performance measures that management use to evaluate the entity's performance.

Historical financial statements are often criticised for lacking adequate discussion about risk. The inclusion of management commentary would therefore be extremely beneficial to the primary users of the financial statements – current and potential investors as well as lenders and other creditors. This should help them to make more informed economic decisions.

Providing useful information

Performance measures should be reported in a consistent manner to enable comparability of the management commentary over time. Comparability with other entities is enhanced if the entity discloses performance measures widely used by the industry it operates in. Entities are encouraged to present non-financial performance measures because these are typically absent from traditional financial reporting.

Management commentary should not be generic. This additional clutter makes it harder for investors to locate relevant information within the report.

Test your understanding 2 – Management commentary

The directors of Carsoon are committed to producing high quality reports that enable its investors to assess the performance and position of the business. They have heard that the Board has published a Practice Statement on management commentary. However, they are unsure what is meant by management commentary, and the extent to which it provides useful information.

Required:

Discuss the nature of management commentary and the extent to which it embodies the qualitative characteristics of useful financial information (as outlined in the *Conceptual Framework*).

7 Developments in sustainability reporting

This content was covered in Chapter 22 Analysis and Interpretation.

8 Extant standards

Although developments in the accountancy profession and forthcoming standards are central to the SBR syllabus, it is also important to be able to critique existing accounting standards. Critiques of existing standards can be found within the relevant chapters in this text. For example:

- IAS 1 *Presentation of Financial Statements* – Chapter 3
- IFRS 15 *Revenue from Contracts with Customers* – Chapter 4
- IFRS 2 *Share-based payments* – Chapter 10
- IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* – Chapter 11
- IFRS 8 *Operating Segments* – Chapter 14
- IFRS 3 *Business Combinations* – Chapter 18
- IAS 7 *Statement of Cash Flows* – Chapter 21

Test your understanding 3 – Mineral

Mineral owns a machine that is central to its production process. At the reporting date, the machine's carrying amount exceeds its tax base. This difference is due to the revaluation of the asset to fair value in the financial statements. Due to its importance, it is extremely unlikely that the machine will be sold.

At the year-end, Mineral received $10 million. In return, Mineral must issue ordinary shares in 12 months' time. The number of shares to be issued will be determined based on the quoted price of Mineral's shares at the issue date.

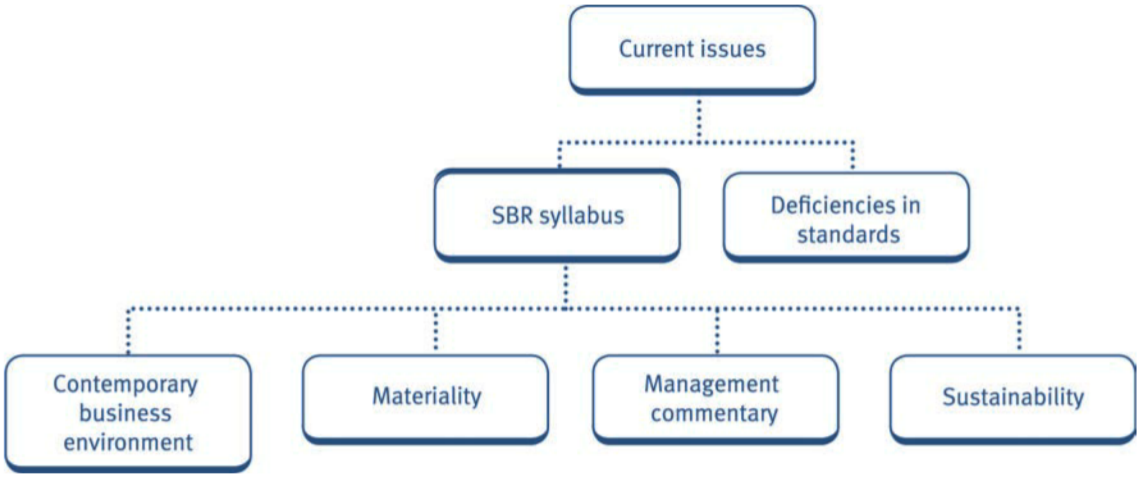
Required:

For each of the transactions above:

(i) **Briefly explain how it should be accounted for in accordance with International Financial Reporting Standards**

(ii) **Discuss why the accounting treatment could be argued to contradict the definition of the elements given by the *Conceptual Framework*.**

9 Chapter summary



Test your understanding answers

Test your understanding 1 – Middleshop
The economic downturn and the periods of closure are indicators that Middleshop's stores are impaired. Poor functionality and low-use suggests that the website might be impaired too. As such, per IAS 36 *Impairment of Assets*, impairment reviews must be carried out. This involves comparing the carrying amount to the recoverable amount. It is unlikely that individual assets can be tested for impairment so need to be tested as part of a cash generating unit (CGU). It may be that each store is a CGU. Any impairment of the assets will be charged to profit or loss. IAS 38 *Intangible Assets* requires annual review of the amortisation period. It would seem that the useful life of the website is too high because it will probably require replacement in the near future. Any change in the useful life is dealt with in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. Amortisation rates are an estimate and so changes are dealt with prospectively (i.e. in current and future periods). Due to the decline in customer demand, Middleshop is likely to be holding surplus inventories. Per IAS 2 *Inventories*, inventories should be measured at the lower of cost and net realisable value. Surplus stock might be disposed of, or scrapped, for zero proceeds or sold at a heavy discount. This may result in net realisable value falling below cost. Any expense that arises on remeasurement of inventories will be recognised in profit or loss. According to IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, a provision must be recognised if there is a present obligation from a past event that will lead to a probable outflow of resources that is capable of being measured reliably. There is no obligation to pay redundancy because there is no detailed restructuring plan in place. There is no obligation to incur the future operating loss because Middleshop could choose to cease trading. As such, Middleshop cannot provide for the redundancy costs or the future operating loss. Due to Middleshop's economic downturn, it may not have sufficient cash to repay its short-term bank loans, creating an uncertainty over whether the entity is a going concern. In accordance with IAS 1 *Presentation of Financial Statements*, going concern uncertainties must be disclosed in the notes to the financial statements.

Test your understanding 2 – Management commentary

Management commentary

Management commentary is a narrative report in which management provide context and background against which stakeholders can assess the financial position and performance of a company. It is not mandatory to produce a management commentary. However, if entities produce a management commentary then it should include information that is essential to an understanding of:

- the nature of the business
- management's objectives and its strategies for meeting those objectives
- the entity's resources, risks and relationships
- the results of operations and prospects, and
- the key performance measures that management use to evaluate the entity's performance.

Management commentary should include forward-looking information. The commentary should be entity-specific, rather than generic.

Link to *Conceptual Framework*

The Practice Statement states that management commentary should include information that possesses the qualitative characteristics of useful financial information. The fundamental qualitative characteristics are relevance and faithful representation. The enhancing qualitative characteristics are understandability, verifiability, comparability and timeliness.

Management commentary provides users with information about risk management, as well as the extent to which current performance may be indicative of future performance. This forward-looking information is relevant because it helps users to make decisions about whether to hold or sell investments in an entity.

To enhance relevance, management commentary should include material information and should focus on the most important information. Generic information is not relevant and should be avoided.

To maximise understandability, management commentary should be presented in a clear and straightforward manner.

When selecting key performance measures, management should use those that are accepted and used widely within the industry. This will enable users to draw comparisons between entities. Management should calculate and report performance measures consistently over time, thus enabling users to compare the performance of the entity year-on-year.

If information from the financial statements is adjusted for inclusion in management commentary then this fact should be disclosed. Financial performance measures should be reconciled to the figures in the financial statements. Users are therefore able to verify the nature of the calculations. They can also assess whether the performance measures included offer a faithful presentation of the entity's financial performance and position.

Test your understanding 3 – Mineral

Deferred tax

The carrying amount of the asset exceeds the tax base. Per IAS 12 *Income Taxes* a deferred tax liability must be recognised. This is measured by multiplying the temporary difference by the tax rate. The tax charge will be recognised in other comprehensive income.

Deferred tax is an application of the accruals concept in that it recognises the tax effects of a transaction in the period when the transaction occurs. Mineral has no plans to sell this asset so there is no present obligation to pay tax that arises on its disposal. The *Conceptual Framework* defines a liability as '**a present obligation of the entity to transfer an economic resource as a result of a past event**' (para 4.26).The deferred tax liability does not appear to meet the definition of a liability in the *Conceptual Framework*.

However, the Board rejects this position. They argue that increases in the carrying amount of an asset must result in future economic benefits for the reporting entity (otherwise the carrying amount is overstated) and that these inflows of economic benefits will be subject to tax. For example, the machine's fair value gain may be due to higher selling prices for its output, which will therefore increase taxable profits. The Board argue that tax is payable on the revaluation irrespective of how the asset is used.

Financial instruments

IAS 32 *Financial Instruments: Presentation* states that a financial liability is a contract to deliver cash, another financial asset, or a variable number of the entity's own shares.

The contract requires that Mineral delivers as many of its own equity instruments as are equal in value to a certain amount. Per IAS 32, this contract should be classified as a financial liability.

An equity instrument is not a resource of an entity and so this contract does not represent an obligation to transfer an economic resource. This means that the financial liability does not meet the definition of a liability in the *Conceptual Framework*.

Chapter

24

UK GAAP

Chapter learning objectives

This chapter contains the additional syllabus content required for those sitting the SBR UK exam. If you are sitting the SBR INT exam then you **do not** need to study this chapter.

Upon completion of this chapter you will be able to:

- Discuss the financial reporting requirements for UK and Republic of Ireland entities (UK GAAP) and their interaction with the Companies Act requirements
- Discuss the reasons why an entity might choose to adopt FRS 101 or FRS 102
- Discuss the scope and basis of preparation of financial statements under UK GAAP
- Discuss the concepts and pervasive principles set out in FRS 102
- Discuss and apply the principal differences between UK GAAP and IFRS.

PER

One of the PER performance objectives (PO7) is to prepare external financial reports. You take part in preparing and reviewing financial statements – and all accompanying information – and you do it in accordance with legal and regulatory requirements. Working through this chapter should help you understand how to demonstrate that objective.

1 Purpose of chapter

This chapter contains the additional syllabus content required for those sitting the SBR UK exam.

If you are sitting the SBR INT exam then you **do not** need to study this chapter.

2 UK GAAP

The accounting standards

Guidance about the accounting standards that UK companies should apply is found within FRS 100 *Application of Financial Reporting Requirements*. The rules are as follows:

- Listed groups must prepare their accounts under IFRS Standards.
  - However, the companies within the group can take advantage of disclosure exemptions outlined in FRS 101 when preparing their individual (non-consolidated) financial statements.
- Other UK companies will apply FRS 102 *The Financial Reporting Standard Applicable in the UK and the Republic of Ireland* unless:
  - they voluntarily choose to apply IFRS, or
  - they are a micro-entity and choose to apply FRS 105 *The Financial Reporting Standard Applicable to the Micro-Entities Regime*.
- A small entity that applies FRS 102:
  - does not have to show other comprehensive income
  - does not have to produce a statement of cash flows
  - is exempt from many of the disclosure requirements of FRS 102.

FRS 101 *Reduced Disclosure Framework*

FRS 101 permits exemptions from many of the disclosure requirements found in International Financial Reporting Standards. FRS 101 can only be applied in the individual financial statements of subsidiaries and parent companies that otherwise fully apply International Financial Reporting Standards.

Some public interest entities, such as banks, cannot take advantage of all of the exemptions outlined in FRS 101. These entities must still make disclosures with regards to financial instruments and fair value.

The application of FRS 101 results in cost-savings and time-savings for entities without severely impacting the quality of financial reporting. Moreover full disclosures on a group level can be found in the consolidated financial statements, and these are likely to be of greater use for investors and lenders.

FRS 105 *The Financial Reporting Standard Applicable to the Micro-entities Regime*

Micro-entities can choose to prepare their financial statements in accordance with FRS 105.

An entity qualifies as a micro-entity if it satisfies two of the following three requirements:

- Turnover of not more than £632,000 a year
- Gross assets of not more than £316,000
- An average number of employees of 10 or less.

FRS 105 is based on FRS 102 but with some amendments to satisfy legal requirements and to reflect the simpler nature of micro-entities. For example, FRS 105:

- Prohibits accounting for deferred tax
- Prohibits accounting for equity-settled share-based payments prior to the issue of the shares
- Prohibits the revaluation model for property, plant and equipment, intangible assets and investment properties
- Prohibits the capitalisation of borrowing costs
- Prohibits the capitalisation of development expenditure as an intangible asset
- Simplifies the rules around classifying a financial instrument as debt or equity
- Removes the distinction between functional and presentation currencies.

There are very few disclosure requirements in FRS 105.

FRS 102 *The Financial Reporting Standard Applicable in the UK and the Republic of Ireland*

FRS 102 is a single standard that is organised by topic. It is based on IFRS for Small and Medium Entities (the SMEs Standard), although there are some differences.

The UK syllabus requires students to be able to discuss the concepts and pervasive principles set out in FRS 102 (the equivalent of the Conceptual Framework for Financial Reporting). These are outlined below.

Objective of financial statements

FRS 102 says that the objective of financial statements is to provide information about an entity's financial position, performance and cash flows, as well as the results of the stewardship of management. This information should be useful to a range of users.

Qualitative characteristics of information

- **Understandability** – information should be understandable to users with a reasonable knowledge of business and accounting.
- **Relevance** – information should be capable of influencing the economic decisions of users.
- **Materiality** – information is material, and is therefore relevant, if its omission or misstatement could influence the economic decisions of users.
- **Reliability** – information is reliable if it is free from material error, bias, and offers a faithful representation of the transactions an entity has entered into.
- **Substance over form** – transactions should be accounted for in accordance with their economic substance rather than their legal form.
- **Prudence** – caution should be exercised when making judgements.
- **Completeness** – the information included in financial statements should be complete, within the bounds of cost and materiality.
- **Comparability** – users should be able to compare the financial statements of an entity through time, and they should also be able to compare the financial statements of different entities.
- **Timeliness** – information is more relevant if it is provided without undue delay.
- **Balance between benefit and cost** – the benefits that information provides to users should exceed the cost of providing it.

Elements and recognition

The definitions of the elements are as follows:

- **Assets** – a resource controlled by an entity from a past event from which future economic benefits are expected to flow to the entity.
- **Liabilities** – a present obligation of an entity from a past event, the settlement of which is expected to result in an outflow of economic benefits.
- **Equity** – the residual interest in the assets of the entity after deducting all its liabilities.
- **Income** – increases in economic benefits in the reporting period that result in an increase in equity (other than contributions from equity investors).
- **Expenses** – decreases in economic benefits in the reporting period that result in a decrease in equity (other than distributions to equity investors).

An element should be recognised in the financial statements if:

- It is probable that economic benefits will flow to or from the entity
- Its cost or fair value can be measured reliably.

The above definitions and recognition criteria are based on the 2010 *Conceptual Framework*. As such, the definitions of assets and liabilities and the recognition criteria outlined in FRS 102 differ from those in the 2018 *Conceptual Framework*.

Measurement

FRS 102 says that there are two common measurement bases:

- **Historical cost** – the amount of cash and cash equivalents paid to acquire an asset, or the amount of cash and cash equivalents received in exchange for an obligation.
- **Fair value** – the amount for which an asset could be exchanged, or a liability settled, between knowledgeable parties in an arm's length transaction.

Accruals basis

FRS 102 emphasises that financial statements, other than statements of cash flow, are prepared using the accruals basis.

Offsetting

An entity should not offset assets and liabilities unless required to or permitted by FRS 102.

Test your understanding 1 – FRS 105

You advise a client who is in the process of incorporating a new UK-based company. The company would qualify as a micro-entity and, as such, could apply FRS 105 *The Financial Reporting Standard applicable to the Micro-entities Regime*. Alternatively, it could apply FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland*.

Required:

What factors should be considered when establishing whether the client should use FRS 105?

3 Examinable differences between International and UK standards

Students sitting the UK paper are required to know the key differences between FRS 102 and IFRS Standards. These are outlined below:

Concepts and principles

FRS 102 notes that there are two commonly used measurement bases. These are:

- Historical cost, and
- Fair value.

In contrast, the *Conceptual Framework* outlines:

- Historical cost, and
- Current value.

Financial statement presentation

True and fair override

To comply with Companies Act, FRS 102 allows a 'true and fair override'. If compliance with FRS 102 is inconsistent with the requirement to give a true and fair view, the directors must depart from FRS 102 to the extent necessary to give a true and fair view. Particulars of any such departure, the reasons for it and its effect are disclosed.

Statement of financial position

In the UK, Companies Act requirements dictate the format of the statement of financial position. It is set out as follows:

Assets – Liabilities = Equity

Income statement

FRS 102 refers to the statement of financial performance as the 'income statement' (as opposed to 'the statement of profit or loss'). Its format is dictated by Companies Act.

If activities are discontinued during the year, FRS 102 requires that a line-by-line analysis is provided on the face of the income statement in a column called 'discontinued operations'. In contrast IFRS 5 Non-current Assets Held for Sale and Discontinued Operations allows a single figure to be presented on the face of the statement of profit or loss (with more detailed analysis provided in the disclosure notes).

Statement of cash flows

Under FRS 102, small entities, mutual life assurance companies, pension funds and certain investment funds are not required to produce a statement of cash flows. This exemption does not exist in IAS 7 *Statement of Cash Flows*.

Inventories

FRS 102 provides more guidance than IAS 2 *Inventories* about what costs should be included in production overheads. For example, it says that production overheads should include the costs of any obligation to restore a site on which an item of property, plant and equipment is located that are incurred during the reporting period as a consequence of having used that item of property, plant and equipment to produce inventory.

FRS 102 permits the reversal of inventory impairments, whereas IAS 2 does not.

Changes in accounting policy

FRS 102 states that the change to a cost model when a reliable estimate of fair value in unavailable is not a change in accounting policy. This exemption is not mentioned in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

Financial instruments

Measurement

FRS 102 adopts a simplified approach to financial instruments:

- Investments in shares are measured at fair value through profit or loss if their fair value can be reliably measured. Otherwise, they are measured at cost less impairment.
- Simple debt instruments (whether receivable or payable) are measured at amortised cost.
- Commitments to make or receive a loan are measured at cost (if any) less impairment.
- More complicated debt instruments (whether receivable or payable) are measured at fair value through profit or loss.

Impairment

FRS 102 adopts an incurred loss model. This means that an impairment loss is only recognised in respect of financial assets if objective evidence of impairment has occurred – such as the bankruptcy of a credit customer.

For an asset measured at amortised cost, FRS 102 says that the impairment loss is calculated as the difference between its carrying amount and the present value of the expected future cash flows (discounted at the original effective rate of interest).

In contrast, IFRS 9 *Financial Instruments* adopts an 'expected loss' model for financial asset impairments. This involves recognising a loss allowance for all financial assets measured at amortised cost or fair value through other comprehensive income (except equity instruments) based on the level of credit risk.

Derecognition

FRS 102 contains simpler rules than IFRS 9 for deciding whether or not to derecognise a financial instrument.

Test your understanding 2 – Cocoa

Cocoa purchased a debt instrument in the current reporting period that is measured at amortised cost. By the reporting date no actual defaults had occurred. However, due to a general economic decline, the directors of Cocoa concluded that credit risk associated with the remaining loan period had increased significantly.

The following credit losses have been calculated:

12 month expected credit losses: $0.3 million

Lifetime expected credit losses: $1.0 million

Required:

Explain how the above should be dealt with under International Financial Reporting Standards and FRS 102.

Joint ventures

FRS 102 uses the term 'joint venture' with regards to any arrangement whereby an economic activity is subject to joint control. FRS 102 says that there are three types of joint ventures:

- Jointly controlled operations – this is where each venturer contributes their own assets for use by the joint venture.
- Jointly controlled assets – this is where the venturers jointly control or jointly own the assets used by the joint venture.
- Jointly controlled entities – this involves the establishment of a separate entity that is under joint control. In the consolidated financial statements, such investments are accounted for using the equity method.

IFRS 11 *Joint Arrangements* classifies activities subject to joint control in one of two ways:

- joint operations – where the venturers have rights to the assets, and obligations for the liabilities, of the operation.
- joint ventures – where the venturers have rights to the net assets of the arrangement, usually as a result of a separate entity being established.

Investment property

FRS 102 requires the use of the fair value model unless the fair value cannot be determined reliably. In contrast, IAS 40 *Investment Property* allows entities to measure investment property using either the cost model or the fair value model.

FRS 102 allows an entity that rents investment property to another company in the same group to account for it as property, plant and equipment in its separate financial statements. If so, it is measured at cost less depreciation. IAS 40 does not permit this treatment.

IAS 40 states that a property which is held to earn rental income should be treated as property, plant and equipment if ancillary services are provided that are significant to the arrangement e.g. the services provided to hotel guests. FRS 102 does not cover this situation.

Intangible assets

Development

FRS 102 says that the capitalisation of development expenditure is **optional**. In contrast IAS 38 *Intangible Assets* **requires** that development expenditure is capitalised if certain criteria are met.

Grants

FRS 102 specifies that an intangible asset acquired by way of a grant shall be recognised at its fair value on the date that the grant is received or receivable.

Useful life

FRS 102 specifies that intangible assets should be considered to have a definite useful economic life. FRS 102 says that if the useful life of an intangible asset cannot be measured reliably then it must be estimated. The estimate used should not exceed ten years.

IAS 38 allows entities to regard an intangible asset as having an indefinite useful economic life if it cannot foresee an end to the period over which the asset will generate economic benefits.

Non-current assets

Held for sale

FRS 102 does not contain the concept of 'held for sale'. As such, assets are depreciated or amortised up to the date of disposal. However, FRS 102 identifies the decision to sell an asset as a potential indicator of impairment, meaning that an impairment review should be performed.

Borrowing costs

Under FRS 102, an entity **may** adopt a policy of capitalising borrowing costs. IAS 23 Borrowing Costs **requires** that borrowing costs attributable to a qualifying asset are capitalised.

FRS 102 is more specific than IAS 23 about the capitalisation rate to be used.

Estimate reviews

FRS 102 only requires entities to review the useful economic life of assets if evidence exists that they have changed. IAS 16 Property, Plant and Equipment and IAS 38 Intangible Assets require that an entity reviews residual values and useful lives annually.

Test your understanding 3 – Jelly Roll

Jelly Roll has a year end of 31 December 20X1. On 30 June 20X1 the directors made the decision to sell a building. On this date the building – classified as property, plant and equipment – had a carrying amount of $2 million, a remaining useful life of 20 years, and nil residual value. The building was immediately advertised for sale at its fair value of $5 million and a sale within 12 months was deemed to be highly probable.

Costs to sell are negligible and can be ignored.

Required:

How should the above be treated in accordance with International Financial Reporting Standards and FRS 102?

Leases

FRS 102 requires lessees to classify leases as operating leases or finance leases and account for them as follows:

- Finance leases – an asset and liability is recognised at the lower of the asset's fair value and the present value of the minimum lease payments. Depreciation on the asset and interest on the liability is charged to profit or loss.
- Operating leases – lease payments are recognised as an expense in profit or loss on a straight line basis.

This means that no liability is recognised in respect of operating leases in the financial statements of a lessee, even though it meets the definition of a liability as outlined in FRS 102.

IFRS 16 *Leases* requires lessees to recognise a lease liability and right-of-use asset in respect of all leases, unless short-term or of low value.

Provisions

IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* provides detailed guidance on restructuring provisions – such as when a constructive obligation arises, and the amounts that can be included in the provision. FRS 102 simply states that a provision for restructuring costs should be recognised when a legal or constructive obligation exists.

In accordance with FRS 102, financial guarantee contracts (such as when one company guarantees the overdraft or loan of another company) may be classified as provisions or contingent liabilities (depending on the probability of payment). Under International Financial Reporting Standards, financial guarantee contracts are accounted for using IFRS 9 *Financial Instruments*.

Revenue

FRS 102 splits revenue accounting into three main areas:

- Revenue from goods – recognised when the risks and rewards of ownership transfer from the buyer to the seller.
- Revenue from services – recognised according to the stage of completion.
- Revenue from construction contracts – recognised according to the stage of completion.

IFRS 15 *Revenue from Contracts with Customers* adopts a five step model for revenue recognition.

Government grants

Recognition

Under FRS 102, two methods of recognising government grants are allowed:

The performance model – If no conditions are attached to the grant, it is recognised as income immediately. If conditions are attached to the grant, it is only recognised as income when all conditions have been met.

The accruals model – Grants are recognised as income on a systematic basis, either as costs are incurred (revenue grants) or over the asset's useful life (capital grants).

IAS 20 *Accounting for Government Grants and the Disclosure of Government Assistance* adopts an accruals model for government grant recognition.

Repayment

A government grant may need to be repaid if its conditions are not complied with. IAS 20 provides detailed guidance on how to deal with the repayment of a government grant. FRS 102 simply says that a liability should be recognised when the repayment meets the definition of a liability.

Share-based payment

Valuation

When measuring the fair value of equity instruments granted, FRS 102 requires the use of a three tier hierarchy:

1 Observable market prices

2 The use of entity specific market data, such as recent transactions in the instrument

3 A valuation method that uses, wherever possible, market data.

Recognition

FRS 102 provides simpler recognition rules than IFRS 2 *Share-based Payment*. For example, under FRS 102, schemes which offer a choice of settlement are not split into an equity component and a liability component. Instead FRS 102 provides rules to determine whether to account for them as a wholly cash-settled transaction or a wholly equity-settled transaction.

Impairment of assets

FRS 102 specifies that a recoverable amount need not be determined unless there are indicators of impairment. In contrast IAS 36 *Impairment of Assets* requires that some assets are subject to annual impairment review (such as goodwill acquired in a business combination).

FRS 102 is much less detailed with regards to impairments than IAS 36.

Employee benefits

Under FRS 102 an entity only accounts for termination benefits when it has a detailed formal plan for the restructuring and has no realistic possibility of withdrawal. In contrast IAS 19 *Employee Benefits* says that termination benefits are recognised at the earlier of:

- the date when the entity can no longer withdraw the offer, and
- the date when costs associated with a restructuring are recognised under IAS 37 *Provisions, Contingent Liabilities and Contingent Assets.*

Income tax

The income tax section of FRS 102 differs significantly from IAS 12 *Income Taxes*.

Profit or loss/statement of financial position

FRS 102 adopts a profit or loss approach to the recognition of deferred tax. Timing differences are defined as differences between taxable profits and total comprehensive income as stated in the financial statements that arise from the inclusion of income and expenses in tax assessments in periods different from those in which they are recognised in financial statements.

FRS 102 makes an exception to this rule. It states that deferred tax should also be recognised based on the differences between the tax value and fair value of assets and liabilities acquired in a business combination.

In contrast, IAS 12 conceptualises deferred tax through the statement of financial position. The standard states that deferred tax should be accounted for based on differences between the amounts recognised for the entity's assets and liabilities in the statement of financial position and the recognition of those assets and liabilities by the tax authorities.

Permanent differences

FRS 102 uses the concept of permanent differences. Permanent differences arise because certain types of income and expenses are non-taxable or disallowable, or because certain tax charges or allowances are greater or smaller than the corresponding income or expense in the financial statements. Deferred tax is not recognised on permanent differences.

IAS 12 does not use the terminology 'permanent difference'. Instead, it says that deferred tax assets and liabilities are recognised for 'temporary differences'.

Foreign currency translation

Unlike IAS 21 *The Effects of Changes in Foreign Exchange Rates*, FRS 102 does not require the presentation of a separate translation reserve for foreign exchange differences arising on the translation of a subsidiary.

Under FRS 102, foreign exchange differences are **not** reclassified from other comprehensive income to profit or loss on the disposal of the overseas subsidiary (whereas they are reclassified under IAS 21).

Events after the reporting period

Under both FRS 102 and IAS 10 *Events after the Reporting Period*, no liability is recognised for dividends declared after the reporting date. However, FRS 102 says that the dividend can be presented as a separate component of retained earnings.

Related parties

FRS 102 has additional disclosure exemptions. It states that disclosures need not be given of transactions entered into between two or more members of a group, provided that any subsidiary which is a party to the transaction is wholly owned by such a member.

FRS 102 only requires disclosure of key management personnel compensation in total. In contrast, IAS 24 *Related Party Disclosures* requires that disclosure of key management personnel compensation is broken down into:

- short-term benefits
- post-employment benefits
- other long-term benefits
- termination benefits
- share-based payments.

Agriculture

FRS 102 says that, for each class of biological assets, an entity can choose to use the cost model or the fair value model. Under the cost model, the asset is measured at cost less accumulated depreciation and accumulated impairment losses. The fair value model is consistent with IAS 41 Agriculture (below).

IAS 41 *Agriculture* requires biological assets to be measured using a fair value model. This means that they are initially recorded at fair value less costs to sell. They are then remeasured to fair value less costs to sell at each reporting date with gains and losses recorded in profit or loss.

Consolidated and separate financial statements

Control

The definition of control in FRS 102 is different from the definition in IFRS 10 *Consolidated Financial Statements*. FRS 102 says that control is the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. FRS 102 says that control is presumed to exist if an entity owns more than half of the voting rights of another entity, although this assumption can be rebutted in exceptional circumstances.

IFRS 10 *Consolidated Financial Statements* says that an investor controls an investee if it:

- has power over the investee
- has rights or exposure to variable returns
- can affect these returns through its power over the investee.

Individual financial statements of a parent

If a parent applies FRS 102 and is required to produce individual financial statements, the parent must measure its investments in subsidiaries using one of the following methods:

- cost less impairment
- fair value with gains and losses in other comprehensive income
- fair value with gains and losses in profit or loss.

IAS 27 *Separate Financial Statements* also allows investments in subsidiaries to be accounted for in the parent's financial statements using the equity method.

Exclusions

FRS 102 says that a subsidiary is excluded from consolidation if severe long-term restrictions hamper the ability of the parent to exercise control. This exemption does not exist in full IFRS Standards.

Business Combinations and goodwill

Consideration

With regards to contingent consideration, FRS 102 states that the estimated amount payable is only included in the calculation of goodwill if it is probable that it will be incurred. Costs directly attributable to the acquisition are also included in the calculation of goodwill (such as legal and professional fees).

Under IFRS 3 *Business Combinations*, contingent consideration is measured at its fair value and included in the calculation of goodwill. The fair value of the contingent consideration will incorporate the probability that the payment will be made. Any transaction costs related to the acquisition are expensed to profit or loss.

Control in stages

If control in a subsidiary is achieved in stages (e.g. from a 10% holding to a 60%) then IFRS 3 *Business Combinations* requires earlier investments to be remeasured to fair value at the date control is achieved. In contrast FRS 102 says that the earlier share purchases are not remeasured.

Net assets of acquiree

IFRS 3 *Business Combinations* says that intangible assets other than goodwill arising from a business combination are recognised at fair value if they are separable or if they arise from legal or contractual rights.

FRS 102 only **requires** recognition of intangible assets other than goodwill arising on a business combination if they are separable **and** arise from legal or contractual rights. However, FRS 102 permits entities to recognise additional intangibles if they are separable **or** if they arise from legal or contractual rights.

Negative goodwill

According to FRS 102, negative goodwill (where the fair value of the net assets acquired exceeds the consideration) is recognised on the statement of financial position immediately below goodwill. It should be followed by a subtotal of the net amount of goodwill and the negative goodwill, i.e. it is presented as a negative asset.

The subsequent treatment of negative goodwill is that any amount up to the fair value of non-monetary assets acquired is recognised in profit or loss in the periods in which the non-monetary assets are recovered. Any amount exceeding the fair value of non-monetary assets acquired must be recognised in profit or loss in the periods expected to be benefited.

IFRS 3 *Business Combinations* refers to negative goodwill as a 'gain on bargain purchase'. This is recognised immediately in profit or loss.

Amortisation

FRS 102 requires that goodwill is amortised over its useful economic life. If this cannot be reliably measured then the useful life should not exceed ten years.

Under International Financial Reporting Standards, goodwill is not amortised but is instead subject to an annual impairment review.

Non-controlling interest (NCI)

FRS 102 requires that the NCI at acquisition is only measured using the proportionate method.

IFRS 3 *Business Combinations* allows the NCI at acquisition to be measured at either:

- Fair value, or
- Its proportionate share of the subsidiary's identifiable net assets.

Fair value

IFRS 3 *Fair Value Measurement* includes more detailed information on fair values than FRS 102.

Subsidiaries held exclusively with view to resale

In the consolidated financial statements, FRS 102 requires that an election is made to measure such investments at either:

- cost less impairment, or
- fair value with gains and losses in other comprehensive income, or
- fair value with gains and losses in profit or loss.

If the subsidiary is held as part of an investment portfolio, then it must be measured at fair value with gains and losses in profit or loss.

In contrast, IFRS 5 *Assets Held for Sale and Discontinued Operations* requires that a subsidiary acquired for resale is classified as 'held for sale'. This means that all of its assets will be amalgamated into one line in the statement of financial position, and all of its liabilities will be amalgamated into another line.

Associates

FRS 102 specifies that any transactions costs are added onto the initial carrying amount of an associate. Under International Financial Reporting Standards, these costs are expensed to profit or loss.

FRS 102 specifies that any difference between the consideration paid to acquire an associate and the investor's share of the fair value of the associate's net assets is implicit goodwill. This goodwill should be amortised over its useful economic life.

Test your understanding 4 – Peanut

On 1 January 20X1, Peanut acquired 30% of the ordinary shares of Almond for $4 million.

At this date, Almond's identifiable net assets were carried at $10 million. This was the same as their fair value. The useful economic life of any goodwill acquired cannot be measured reliably, but Peanut used the largest estimate permitted.

In the year ended 31 December 20X1, Almond made a profit after tax of $2 million.

Required:

In accordance with FRS 102, explain how the investment in the associate should be accounted for in the consolidated financial statements for the year ended 31 December 20X1.

Test your understanding 5 – Pizza

On 31 December 20X1, Pizza acquires 80% of Spaghetti. Pizza pays $3 million cash and will pay further cash consideration in one year's time if Spaghetti exceeds profit targets. The present value of this arrangement is $2 million and the fair value is $1.3 million. The directors believe that there is a 60% chance that the profit target will be met. Legal fees of $0.1 million were also incurred and are directly attributable to the purchase of the shares.

The fair value of Spaghetti's net assets at the acquisition date is $7 million. The fair value of the non-controlling interest at acquisition is $1.2 million.

Required:

In accordance with FRS 102, explain how the above will be dealt with in the consolidated financial statements for the year ended 31 December 20X1.

4 Companies Act

The UK syllabus specifies that candidates must know the following basic Companies Act requirements relating to single and group entity financial statements.

Single entity financial statements

A company is exempt from the requirement to prepare individual accounts for a financial year if:

- it is itself a subsidiary undertaking
- it has been dormant throughout the whole of that year, and
- its parent undertaking is established under the law of an EEA State.

Group financial statements

A company subject to the small companies regime **may** prepare group accounts for the year.

If not subject to the small companies regime, a parent company **must** prepare group accounts for the year unless one of the following applies:

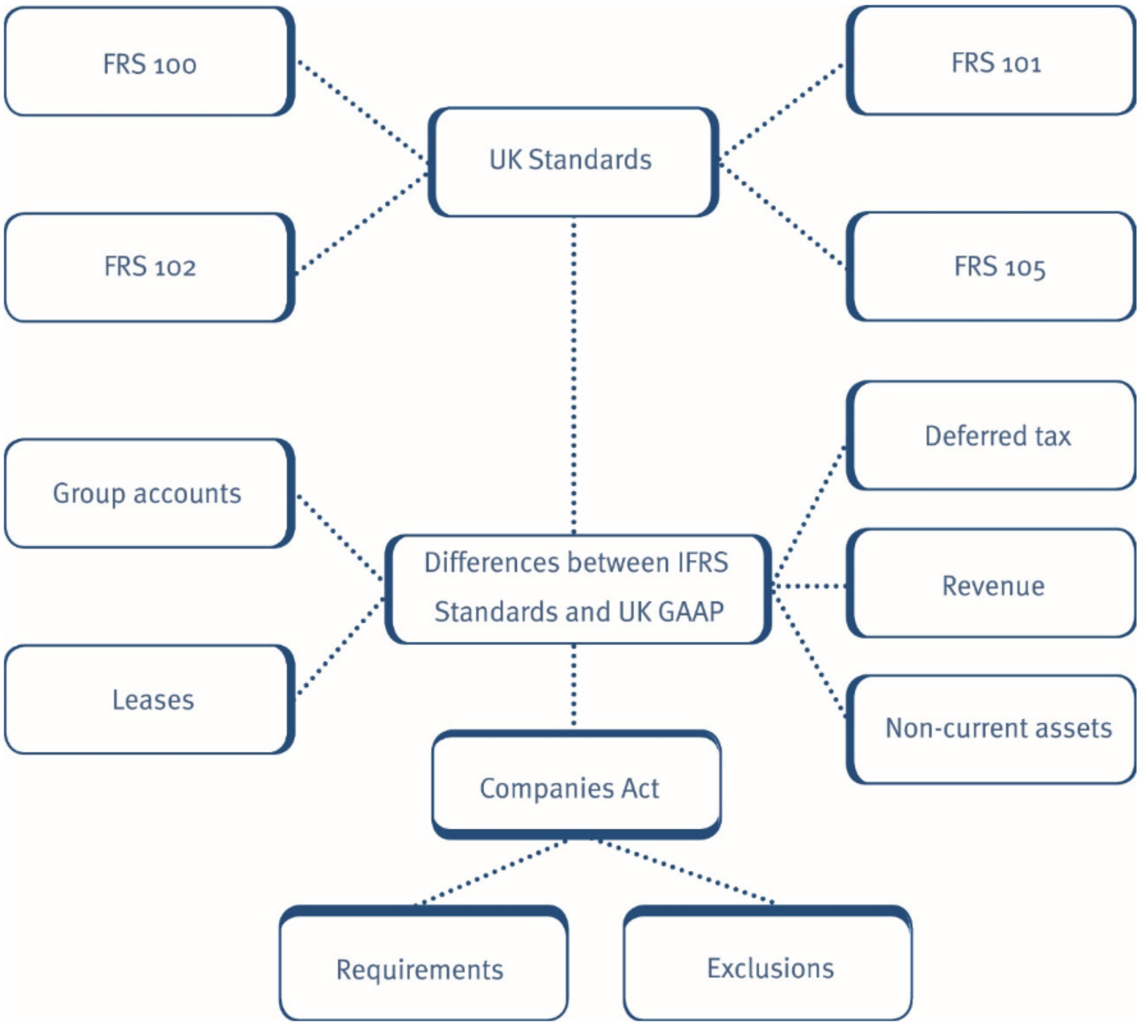
- A company is exempt from the requirement to prepare group accounts if it is itself a wholly-owned subsidiary of a parent undertaking.
- A parent company is exempt from the requirement to prepare group accounts if, under section 405 of Companies Act, all of its subsidiary undertakings could be excluded from consolidation.

Exclusion of a subsidiary from consolidation

Where a parent company prepares Companies Act group accounts, all the subsidiary undertakings of the company must be included in the consolidation, subject to the following exceptions:

- A subsidiary undertaking may be excluded from consolidation if its inclusion is not material for the purpose of giving a true and fair view (but two or more undertakings may be excluded only if they are not material taken together).
- A subsidiary undertaking may be excluded from consolidation where:
  – severe long-term restrictions substantially hinder the exercise of the rights of the parent company over the assets or management of that undertaking
  – the information necessary for the preparation of group accounts cannot be obtained without disproportionate expense or undue delay
  – the interest of the parent company is held exclusively with a view to subsequent resale.

5 Chapter summary



Test your understanding answers

Test your understanding 1 – FRS 105

FRS 105 requires fewer disclosures than FRS 102. This will reduce the time and cost burden of producing financial statements. However, consideration should be given to whether the users of the financial statements will find this lack of disclosure a hindrance to making economic decisions. This is unlikely in the case of such a small company.

FRS 105 does not permit property, plant and equipment, intangible assets or investment properties to be held at fair value. This will have an impact on perception of the company's financial position, particularly if carrying amounts of assets are materially lower than other companies as a result.

Accounting policy choices allowed in FRS 102 have been removed in FRS 105. For instance, borrowing costs and development costs must be expensed. Profits reported under FRS 105 may be lower than if FRS 102 was applied.

If competitors prepare financial statements in accordance with FRS 105 then it will be easier to compare and benchmark performance against them.

If the company is expected to grow quickly, it might be easier to simply apply FRS 102 from the outset. That way, it will avoid the burden of transitioning from FRS 105 to FRS 102 at a later date.

Test your understanding 2 – Cocoa

In accordance with IFRS 9 *Financial Instruments*, a loss allowance should be recognised at an amount equal to lifetime expected credit losses if credit risk has increased significantly since inception. As such an allowance for $1 million, and a corresponding charge to profit or loss, should be recognised.

In accordance with FRS 102, financial asset impairments are calculated if there is objective evidence that impairment has occurred. No objective evidence exists about the particular borrower involved, and no default of payments has occurred. Therefore no impairment loss is recognised.

Test your understanding 3 – Jelly Roll

In accordance with IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*, the building will be classified as held for sale because its carrying amount will be mainly recovered through a sale. The building will continue to be held at $2 million as this is the lower of its carrying amount and its fair value less costs to sell. No more depreciation will be charged. The building will be reclassified as a current asset.

In accordance with FRS 102, an impairment review should be conducted. However, the asset is not impaired because its fair value is significantly higher than its carrying amount. The building will continue to be classified as property, plant and equipment and will be depreciated. It will have a carrying amount at 31 December 20X1 of $1.95 million ($2m × 19.5/20).

Test your understanding 4 – Peanut

The associate is initially measured at its cost of $4 million.

The carrying amount of associate will be increased by Peanut's share of the profit after tax, which amounts to $0.6 million ($2m × 30%). This will also be recorded in profit or loss.

On the purchase of the associate, implicit goodwill of $1 million ($4m – (30% × $10m)) arose. If the useful life of goodwill cannot be estimated reliably then the maximum permitted estimate is 10 years. The amortisation charge of $0.1 million ($1m/10 years) will reduce the carrying amount of the investment and will also be charged against profit or loss.

The total carrying amount of the investment in the associate in the consolidated statement of financial position will be $4.5 million ($4m + $0.6m – $0.1m).

The share of the profits of the associate reported in the income statement is $0.5 million ($0.6m – $0.1m).

Test your understanding 5 – Pizza

The present value of the contingent consideration will be included in the goodwill calculation because it is probable that it will be paid. FRS 102 requires that costs related to the acquisition are also included in the goodwill calculation.

FRS 102 does not permit the NCI at acquisition to be measured at fair value. Only the proportionate method can be used.

	$m
Cash consideration	3.0
Contingent consideration	2.0
Fees	0.1
NCI at acquisition ($7m × 20%)	1.4
FV of identifiable net assets at acquisition	(7.0)
Negative goodwill	(0.5)

The negative goodwill is not recognised as a gain in profit or loss but instead as a negative asset on the statement of financial position.

Chapter

25

Employability and technology skills

Chapter learning objectives

This chapter contains an overview of the employability and technology skills syllabus area.

1 Purpose of chapter

This chapter explains the content included within the employability and technology skills syllabus area. A similar syllabus area is included in all Applied Skills (except LW) and Strategic Professional level syllabi.

ACCA exams utilise software and technology similar to those used in the modern workplace. By studying ACCA exams, candidates will be equipped with both technical syllabus knowledge and practical, applied software skills. The employability and technology skills syllabus area is included within the syllabus to acknowledge this acquired skillset.

2 Content of the employability and technology skills syllabus area

The employability and technology skills syllabus area is outlined in the syllabus and study guide. It consists of the following:

1 Use computer technology to efficiently access and manipulate relevant information.

2 Work on relevant response options, using available functions and technology, as would be required in the workplace.

3 Navigate windows and computer screens to create and amend responses to exam requirements, using the appropriate tools.

4 Present data and information effectively, using the appropriate tools.

Whilst sitting an exam, candidates will be using the functionality of the CBE software in a variety of ways e.g. to prioritise information within the question data provided, to organise and present their answers in a manageable fashion, to use shortcuts and software functionality to increase efficiency. Skills garnered in the workplace can be used in the examination and vice versa.

3 CBE support and the ACCA Exam Practice Platform

ACCA candidates can access the ACCA's Exam Practice Platform to practice attempting questions using the CBE software. It is imperative that candidates are familiar with the software before attempting the exam.

The link to the SBR Exam Practice Platform access gateway can be found here:

https://bit.ly/3ouwNgf

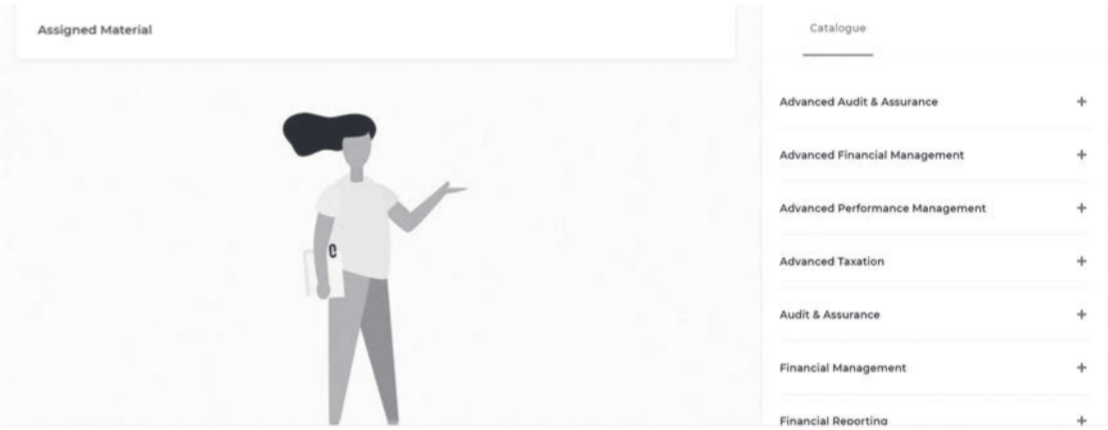
A MyACCA login is required to access the platform.

Support, access to other papers, tutorial videos and CBE advice can be found here:

https://bit.ly/3CJuoVU

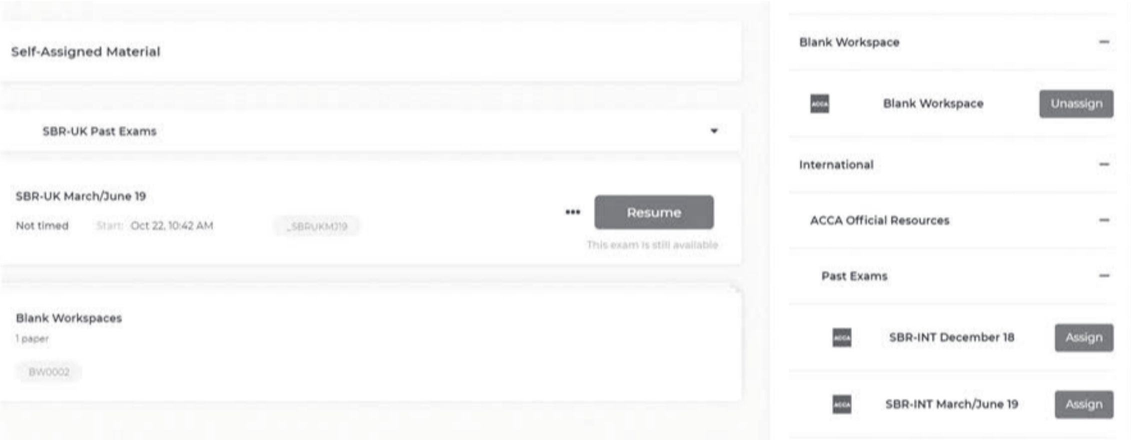
4 Contents of the CBE and Exam Practice Platform

On entering the Exam Practice Platform, candidates will access their dashboard, as follows:



Candidates should click their appropriate paper in the right hand side menu. There they will be able to 'assign' content to their workspace. Candidates can assign a blank workspace or ACCA official resources (which include past papers presented using the CBE software for the candidates to attempt) to their workspace.

This will be added to the candidate's 'Self-Assigned Material' listing as below:



When working within the assignment the candidate will use response options to provide their answer.

The **Response Options** are where the candidate will attempt their answers.

The response options for SBR are:

– the word processor, and

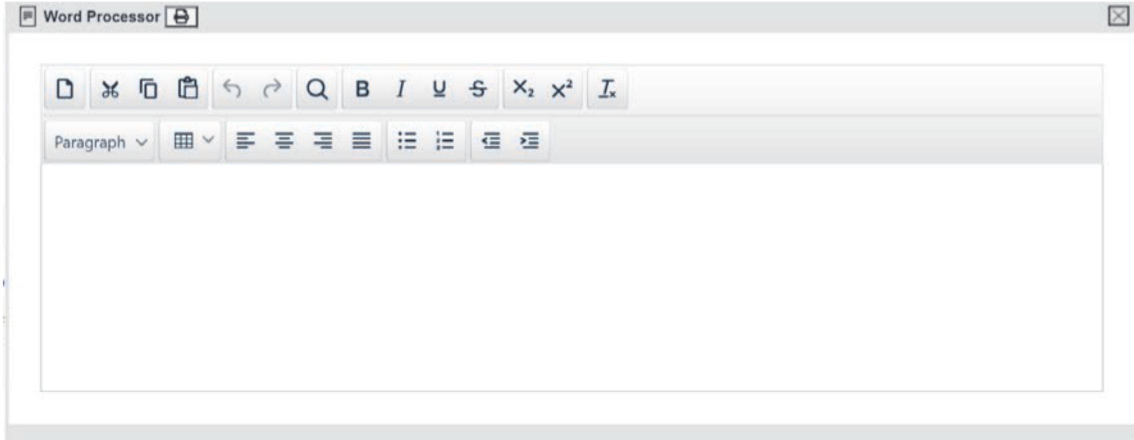
– the spreadsheet.

The candidate must determine which of the response options is the most suitable for their specific answer.

These replicate the functionality of widely used software packages. The ACCA has developed this software, for use during home question practice and under exam conditions, to replicate the practical skill sets and work-based behaviours adopted by various industries throughout the world. By studying the ACCA qualification, candidates will improve, not only on their technical knowledge and understanding, but also on skills applied on a daily basis within their work environments. Candidates should practise questions using the CBE platform to ensure they are familiar with the various functions available within their specific examination.

Word Processor

The word processor response option, when relevant, will appear as follows:



This resource has the following advantages and disadvantages:

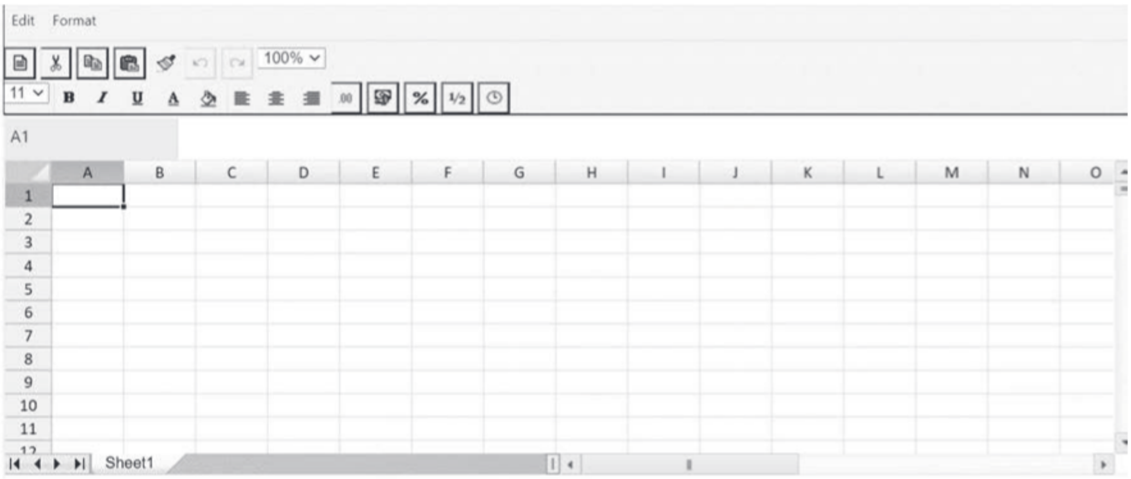
Advantages	**Disadvantages**
It is easier to continue typing without entering new cells or becoming concerned about cell width	It cannot automatically perform calculations
Answers can be more easily split into paragraphs to make them more visually appealing and easier to mark	Numerical tables can be difficult to label and align
Bullet points can be used to present lists	
Text can be easily aligned and justified	
Superscript and subscript can be easily added to express terms such as 4^2, for example	

It is, therefore, best suited to discursive answers where candidates are asked, for example, to discuss, analyse or evaluate issues from a scenario or calculation.

The word processing software application could be used in the workplace within the writing of meeting agendas, meeting minutes, external letters, marketing output, briefings, audit reports, textbooks and instructional documentation.

Spreadsheet

The spreadsheet response option, when relevant, will appear as follows:



The spreadsheet software uses the same functionality as other commonly used spreadsheet software. Basic formulae functionality, such as SUM, power functions (e.g. SQRT) and the use of brackets are all reproduced within the ACCA software. Candidates are advised to practise questions using the software so that they are familiar with the functions available and how they can be utilised to the candidate's advantage through improved efficiency.

This resource has the following advantages and disadvantages:

Advantages	Disadvantages
This can quickly and easily perform calculations (e.g. using sums for totals or formulae for calculations)	Text will carry over beyond one cell and may go across and beyond the page width making answers difficult to follow (and mark)
Data within tables can be easily aligned	Bullet points are difficult to use
Shortcut icons can be used to quickly round figures, change numbers to percentages etc	
Tables can easily and quickly be copied when calculations need to be reperformed (e.g. financial statements for more than one company etc)	
Column width can be adjusted to label length	

It is, therefore, best suited for performing calculations within the examination e.g. goodwill calculations.

Spreadsheet software is ubiquitous in the modern workplace. It has the capacity to record, store and organise huge swathes of data and information relating to all aspects of a business. Examples of only a few of its possible practical applications include the preparation of management and financial accounts, operational controls and record-keeping e.g. expense claims, data analytics, project appraisals, sample size selection and tax computations.

5 Chapter summary

The CBE software will replicate the work that is performed by accountants in a typical workplace. It will be used across the syllabus to support a candidate's answer by providing suitable response options for different types of answers.

These response options will be most suitable in the following instances:

– For discursive answers: it is best to use the word processing option

– For calculations: it is best to use the spreadsheet option

Chapter

26

Questions & Answers

Test your understanding 1 – Cookie

Cookie, a company, prepares its financial statements in accordance with International Financial Reporting Standards. It has investments in several subsidiaries. The Cookie group has a year end of 30 April 20X4.

Biscuit

On 1 May 20X3, Cookie acquired 60% of Biscuit's 10 million $1 ordinary shares. A gain on a bargain purchase arising on the acquisition of Biscuit was calculated using the following data:

	$m
Cash consideration	30
Fair value of NCI at acquisition	45
Carrying amount of net assets at acquisition	80

The gain on bargain purchase was recognised in profit or loss. No entries have been posted in the consolidated financial statements in respect of the following issues:

- As part of the purchase consideration, Cookie issued 5 million of its own $1 ordinary shares. These had a fair value of $4.50 each on 1 May 20X3.
- At the acquisition date Biscuit owned an internally generated brand that was unrecognised in its separate financial statements. The fair value of the brand at this date was $15 million. It was estimated to have a remaining useful economic life of 5 years.
- The recoverable amount of the net assets of Biscuit, including goodwill, was $107 million as at the reporting date. No impairment review has yet been performed.

At the reporting date, Biscuit's retained earnings balance was $84 million in its separate financial statements.

Specialised plant

Included in Cookie's property, plant and equipment is an item of specialised plant. This was internally constructed. Construction began on 1 May 20X3 and was completed on 31 October 20X3. The asset was initially recorded at a cost of $15 million and depreciated based on a useful economic life of five years. A breakdown of the cost is as follows:

	$m
Materials for construction	7.3
Directly attributable labour	2.9
Testing of machine	0.6
Training staff to use machine	0.5
Allocated general overheads	3.7
	15.0

Required:

(a) **Discuss, with calculations, how to correct the accounting errors made in respect of the investment in Biscuit in the consolidated financial statements for the year ended 30 April 20X4. Provide the adjustments required.**

(b) **Discuss how to correct the treatment of specialised plant in the consolidated financial statements for the year ended 30 April 20X4.**

Test your understanding 2 – Pineapple

Pineapple is a public limited company which has investments in a number of subsidiary companies. It has a reporting date of 30 September 20X3 and prepares financial statements in accordance with IFRS Standards.

Sale of shares in Satsuma

Pineapple acquired 70% of Satsuma's 2 million $1 ordinary shares several years ago for cash consideration of $4,900,000. At the acquisition date, retained earnings of Satsuma were $2,045,000 and the fair value of the non-controlling interest was $1,600,000.

On 1 October 20X2, Satsuma had retained earnings of $2,342,000. It made a profit of $568,000 in the year ended 30 September 20X3. Profits accrued evenly.

On 31 March 20X3, Pineapple sold its entire shareholding in Satsuma for $5,600,000. Goodwill arising on the acquisition of Satsuma was impaired by 40% in the year ended 30 September 20X2. Satsuma is geographically and operationally distinct from the rest of the Pineapple group.

Interest-free loan

On 1 October 20X2, Pineapple made an interest-free loan of $1,500,000 to Blueberry, a key supplier that was in financial difficulties. This loan is repayable on 30 September 20X6. If the supplier had borrowed the money from a bank, they would have been charged annual interest of 12%. Pineapple recorded the cash outflow and a corresponding financial asset at $1,500,000. No other accounting entries have been made, except to correctly record the required loss allowance.

Required:

(a) **Discuss how the sale of the shares in Satsuma should be accounted for in the consolidated financial statements of the Pineapple group for the year ended 30 September 20X3.**

(b) **Discuss how to correct the treatment of the interest-free loan in the consolidated financial statements of the Pineapple group for the year ended 30 September 20X3. Provide the adjustments required.**

Test your understanding 3 – Vinyl

Vinyl has investments in many subsidiaries. One of these, CD, is located overseas and prepares its individual statements using the Mark (MK). The presentation currency of the Vinyl group is the dollar ($). An extract from CD's statement of financial position as at 30 September 20X4 is presented below:

Equity	MK(m)
Equity capital MK1 shares)	76
Retained earnings	275
Other components of equity	–
	351

The following information is relevant to the preparation of the consolidated financial statements.

Purchase of CD shares

Vinyl acquired 75% of the ordinary shares in CD on 1 October 20X3 for MK360 million. The fair value of the non-controlling interest at the acquisition date was MK90 million and the retained earnings of CD were MK210 million. There were no other components of equity. The fair value of the net assets of CD approximated their carrying amounts with the exception of a brand. This brand was not recognised by CD but Vinyl estimates that it had a fair value of MK10 million at the acquisition date. The brand was deemed to have an indefinite useful economic life.

CD did not pay any dividends during the reporting period.

The following exchange rates are relevant:

	MK to $1
1 October 20X3	1.2
30 September 20X4	1.7
Average rate for the year to 30 September 20X4	1.4

Convertible bonds

Included within Vinyl's non-current liabilities are the proceeds from the issue of convertible bonds on 30 September 20X4. On this date, Vinyl issued 500,000 $100 4% convertible bonds at par. Interest is payable annually in arrears. These bonds will be redeemed at par for cash on 30 September 20X7, or are convertible into 75,000 ordinary shares. The interest rate on similar debt without a conversion option is 9%.

Required:

(a) **With respect to the translation and consolidation of CD, discuss how to calculate and account for the foreign exchange differences in the consolidated financial statements of the Vinyl group for the year ended 30 September 20X4.**

(b) **Discuss how to correct the treatment of the convertible bond in the consolidated financial statements of the Vinyl group for the year ended 30 September 20X4. Provide the adjustments required.**

Test your understanding 4 – Frank

The following financial statement extracts relate to the Frank Group:

Extracts from consolidated statement of financial position as at 30 September 20X4 (with comparatives)

	20X4	**20X3**
	$m	$m
Non-current assets		
Property, plant and equipment (PPE)	221	263
Goodwill	75	142
Investment properties	82	60
Current assets		
Inventories	256	201
Trade and other receivables	219	263
Current liabilities		
Trade and other payables	524	486

Extracts from consolidated statement of profit or loss and other comprehensive income for the year ended 30 September 20X4

	$m
Profit from operations	79
Share of profit of associate	21
Finance cost	(12)
Profit before tax	88
Other comprehensive income	
Items that will not be reclassified to profit or loss	
Gain on revaluation of PPE	50

Notes

The following information is relevant to the Frank group:

1 PPE with a carrying amount of $12m was disposed of for cash proceeds of $10m. PPE costing $53m was purchased during the period.

2 Investment properties are accounted for at fair value. Gains and losses are recorded within operating income. New investment properties were purchased during the period for $14m in cash.

3 During the reporting period, the Frank Group sold some ordinary shares in Chip, one of its subsidiaries, for $41m cash. Frank held 90% of the ordinary shares in Chip before the sale and 40% of the shares after the sale (leaving it with significant influence). A profit on disposal has been correctly calculated and credited to operating income in the statement of profit or loss. The interest in Chip retained by Frank after the share sale had a fair value of $32m. Goodwill and the non-controlling interest at the disposal date were $40m and $4m respectively.

A breakdown of the carrying amount of Chip's net assets at the date of the share sale is provided below:

	$m
Property, plant and equipment	81
Trade and other receivables	32
Cash and cash equivalents	6
Loans	(30)
Trade and other payables	(55)
Net assets at disposal date	34

Required:

In accordance with IAS 7 *Statement of Cash Flows,* prepare 'cash generated from operations' for the year ended 30 September 20X4 using the indirect method.

Test your understanding 5 – Sunny Days

Sunny Days is an entity that breeds and matures beef cattle for sale. It prepares its financial statements in accordance with International Financial Reporting Standards and has a year end of 30 September 20X4. The directors need help with a number of unresolved accounting issues that are detailed below.

(a) In the financial statements for the year ended 30 September 20X3 Sunny Days reported biological assets of $1.8 million. Cattle with a carrying amount of $0.1 million died during the year ended 30 September 20X4 and Sunny Days sold cattle with a carrying amount of $0.4 million. During the current year, the company purchased new cattle and correctly recognised it at a value of $0.8 million. This was partly funded by an unconditional grant of $0.2 million from a local government agency.

Sunny Days does not have the information available to identify the principal market for its cattle. Details of the prices that Sunny Days could obtain for its entire herd at the two markets available to it at the reporting date are provided below:

	Market 1	**Market 2**
Estimated selling price ($m)	2.6	2.8
Cost of transporting cattle to market ($m)	0.1	0.4
Costs to sell (as % of selling price)	0.5%	0.5%

The farmland used by Sunny Days to rear its cattle was purchased for $3 million on 1 October 20X2 but was revalued to $3.2 million on 30 September 20X3. Due to declining property prices in the area, the land was deemed to have a fair value of $2.7 million as at 30 September 20X4.

(12 marks)

(b) On 1 January 20X4, the government announced new legislation which made some of Sunny Days' farming methods illegal. These laws became effective on 1 September 20X4. Due to short term cash flow difficulties, Sunny Days has not yet started to comply with the new legislation. It is estimated that the cost of compliance will be approximately $0.8 million. The government has said that fines for non-compliance are $0.1 million per month and will be strictly enforced.

The directors of Sunny Days wish to know how to account for the above costs as well as any resulting deferred tax impact. Fines are not a tax allowable expense. Sunny Days pays tax at a rate of 20%.

(6 marks)

(c) Sunny Days enters into a contract with a supplier to use a specific retail unit (Unit 5A) for a period of five years. Unit 5A is part of a larger retail space owned by the supplier. Sunny Days will use the retail unit to sell farm produce to the general public.

During the five year period, the supplier can force Sunny Days to relocate to one of the other retail units. The terms of the contract state that the supplier would have to pay all of Sunny Day's relocation costs, and make a payment to compensate for the inconvenience. The supplier would only benefit from moving Sunny Days if a larger retailer wished to move into Unit 5A and if they were willing to commit to using this space for more than five years. This is thought to be possible, but unlikely.

Sunny Days must open and operate Unit 5A during the hours when the larger retail space is open. However, Sunny Days can sell whatever products it wishes, at whatever prices it determines. The supplier will provide cleaning and security services.

Sunny Days will make fixed quarterly payments to the supplier. Sunny Days must also make an annual variable payment, calculated as a percentage of the revenue generated by Unit 5A.

The directors of Sunny Days require advice on whether this contract contains a lease.

(7 marks)

Required:

Discuss the accounting treatment of the above transactions in the financial statements of Sunny Days for the year ended 30 September 20X4.

Note: the mark allocation is shown against each of the three events above.

(Total: 25 marks)

Test your understanding 6 – Coffee

Coffee is a company with a reporting date of 30 September 20X4. Its financial statements are prepared in accordance with International Financial Reporting Standards. There are a number of unresolved accounting issues, which are detailed below.

(a) The financial controller of Coffee was appointed during the current reporting period. She is concerned that some of the payments made this year are significantly larger than the amounts that were provided and accrued for. The two largest discrepancies are detailed below:

- Legal experts had previously advised Coffee that it would probably be found not liable in a court case concerning breaches in employee health and safety legislation. As such, a contingent liability was disclosed in the financial statements for the period ended 30 September 20X3. However, on 1 July 20X4, Coffee was found liable and was ordered to pay damages of $2 million.

- In its financial statements for the year ended 30 September 20X3, Coffee provided for income tax payable of $3 million. However, in January 20X4, Coffee's records were inspected by the tax authorities and a number of errors were discovered. The tax authorities recommended that Coffee improve its controls and training to prevent such mistakes from happening again. Coffee was not levied with any fines but the authorities deemed that the correct amount of tax payable on profits earned in the period ended 30 September 20X3 was $4 million. Coffee paid this in July 20X4.

Coffee requires advice as to the correct accounting treatment of these two events.

(7 marks)

(b) Coffee makes a number of loans to its customers. The interest rate on these loans is at a market rate. Within the first 12 months, Coffee sells these loan assets to another company called Tea. Tea, which is a subsidiary of Coffee, holds the loans until maturity.

At the period end, Coffee holds loan assets that it has yet to sell to Tea. Coffee wishes to know the accounting treatment of these loan assets in both its individual and group financial statements.

(8 marks)

(c) At the end of the reporting period, Coffee bought 200 kg of gold bullion for $4 million in cash. Gold bullion is traded on an active market and can be bought and sold instantly. The fair value of gold bullion changes erratically, and Coffee made the investment with the intention of trading it at a profit in the short-term.

Coffee is unsure whether the $4 million holding of gold bullion should be classified as cash and cash equivalents in its statement of cash flows.

(5 marks)

(d) On 1 October 20X3, Coffee spent $2 million on acquiring a customer list that would provide benefits to the business for 18 months. Coffee has used its own knowledge and expertise to enhance the customer list, and believes that this enhanced list will bring it benefits indefinitely. The directors estimate that, at the reporting date, the original list has a fair value of approximately $1.5 million and that the enhanced list has a fair value of approximately $5 million.

Coffee requires advice as to the correct accounting treatment of the customer list.

(5 marks)

Required:

Discuss the correct accounting treatment of the above transactions for the year ended 30 September 20X4.

Note: the mark allocation is shown against each of the four events above.

(Total: 25 marks)

Test your understanding 7 – Bath

Bath is a public limited company with a reporting date of 30 September 20X4. Its financial statements are prepared in accordance with International Financial Reporting Standards. There are a number of unresolved accounting issues, which are detailed below.

(a) The directors of Bath have identified a number of operating segments. Details of these are provided below:

	Total revenue	**External revenue**	**Total assets**	**Profit/ (loss)**
	$m	$m	$m	$m
Delivery services	304	281	215	(10)
Vehicle hire	217	96	94	62
Removal services	51	46	173	14
Vehicle repairs	22	14	6	8
Road rescue	15	15	8	3
	609	452	496	77

The segments all earn different gross profit margins and, accordingly, Bath has concluded that they exhibit different economic characteristics.

Bath requires advice as to which of the segments are reportable in its operating segments disclosure note. For this purpose, information provided in parts (b), (c) and (d) should be ignored.

(7 marks)

(b) Bath's road rescue division was launched in the current financial year. Customers are charged an annual upfront fee. If the customer's vehicle breaks down during the following 12 months, Bath will send one of its mechanics out to fix or recover it.

The finance director of Bath has noticed that the vast majority of the road rescue customers did not require any breakdown assistance during the year and so is proposing to recognise revenue upon receipt of the annual fee.

(5 marks)

(c) Bath purchased a new office building on 1 October 20W4 for $20 million and this was attributed a useful economic life of 50 years. On 30 September 20X4, the decision was made to sell the office building. At this date, the fair value was $17 million and costs to sell were estimated to be $0.1 million. The building was immediately marketed for sale at $17 million and it was expected that the sale would occur within 12 months.

In October 20X4, interest rates rose dramatically leading to a sharp decline in the property market. At 31 October 20X4, it was estimated that the fair value of the building was $13 million but Bath has not reduced the advertised sales price of the building.

Bath wishes to know the correct accounting treatment of the office building in the period ended 30 September 20X4.

(6 marks)

(d) During the reporting period, Bath purchased an investment in the shares of Bristol for $16 million and made a designation to measure them at fair value through other comprehensive income. Bath received dividends of $3 million during the reporting period. At the reporting date, the quoted price of the shares was $20 million and the present value of the estimated dividends that Bath will receive over the next 5 years was $18 million.

Bath pays income tax at a rate of 25%. The tax base of the investment in shares is based on historical cost. Since there are no plans to sell the shares, Bath believes that it would be misleading to account for any related deferred tax effects.

Bath requires advice about the accounting treatment of the investment in the shares of Bristol for the period ended 30 September 20X4.

(7 marks)

Required:

Discuss the correct accounting treatment of the above transactions for the year ended 30 September 20X4.

Note: the mark allocation is shown against each of the four events above.

(Total: 25 marks)

Test your understanding 8 – Integrated Reporting

(a) It is sometimes claimed that the primary financial statements and disclosure notes do not satisfy the information needs of user groups, particularly shareholders and other providers of financial capital. As a result, many entities now produce an array of non-financial reports. Integrated Reporting <IR>, in particular, has received increased international recognition. The International Integrated Reporting Framework outlines the purpose and proposed content of an Integrated Report. Although optional, it is hoped that the preparation of Integrated Reports by companies will address some of the problems associated with traditional financial reporting.

Required:

(i) **Discuss the limitations of financial reporting.**

(6 marks)

(ii) **Discuss the purpose and suggested content of an Integrated Report.**

(6 marks)

(iii) **Discuss the extent to which Integrated Reporting addresses the limitations of traditional financial reporting.**

(5 marks)

(b) TinCan is a company involved in developing and manufacturing scientific instruments. Its financial statements are prepared in accordance with International Financial Reporting Standards and it has a reporting date of 30 November 20X4. TinCan has a large team of highly qualified research scientists. Employing these motivated and skilled members of staff enables TinCan to produce the most innovative and desirable products on the market, which are sold at high margins. Employee turnover is very low, with few employees leaving to work for its competitors. This is a result of TinCan's flexible working conditions, commitment to staff training, and high rates of pay.

Required:

In relation to the above issue, explain the likely benefits of TinCan producing an Integrated Report.

(8 marks)

(Total: 25 marks)

Test your understanding answers

Test your understanding 1 – Cookie

(a) **Biscuit**

Cookie has recognised a gain on bargain purchase of $5 million ($30m + $45m – $80m) in profit or loss. However, errors have been made.

Consideration

IFRS 3 *Business Combinations* states that purchase consideration should be measured at its fair value at the acquisition date. As such, the shares issued by Cookie should have been included in the goodwill calculation at $22.5 million (5m × $4.50). This will increase goodwill and equity. The adjustment is as follows:

Dr Profit or loss (to remove gain on bargain purchase)	$5.0m
Dr Goodwill	$17.5m
Cr Share capital	$5.0m
Cr Other components of equity/share premium	$17.5m

Brand

On the acquisition date, Biscuit's identifiable net assets should have been recognised in the consolidated financial statements at fair value. This means that the internally generated brand should have been recognised at $15 million at the acquisition date, reducing goodwill by the same amount. The adjustment required is:

Dr Intangible assets	$15m
Cr Goodwill	$15m

The amortisation charge on the intangible asset should be based on its carrying amount in the consolidated financial statements. As such, amortisation must be charged on the fair value uplift of $15 million. This amounts to $3 million ($15/5 years). The adjustment required is:

Dr Amortisation expense	$3m
Cr Intangible assets	$3m

Of the $3 million expense, $1.8 million ($3m × 60%) is attributable to the equity owners of Cookie and the remaining $1.2 million is attributable to the non-controlling interest.

The brand has a carrying amount at the reporting date of $12 million ($15m – $3m).

Impairment

After adjusting for the above, goodwill arising on the acquisition of Biscuit is $2.5 million ($17.5m – $15m). According to IAS 36 *Impairment of Assets*, goodwill must be subject to annual impairment review. An asset is impaired if its carrying amount exceeds its recoverable amount.

Goodwill does not generate independent cash flows so an impairment review is performed on the cash generating unit that it forms a part of. Goodwill arising on the acquisition of Biscuit does not require grossing up for this review because the full goodwill method was used. The impairment calculation is provided below:

	$m	$m
Year-end net assets:		
Share capital	10	
Retained earnings	84	
Brand uplift	15	
Brand amortisation	(3)	
		106.0
Goodwill		2.5
		108.5
Recoverable amount		(107.0)
Impairment		1.5

The goodwill impairment of $1.5 million is charged to the statement of profit or loss. The adjustment required is:

Dr Profit or loss	$1.5m
Cr Goodwill	$1.5m

Under the full goodwill method, the impairment must be allocated between the group and the NCI based on their shareholdings.

Group share: 60% × $1.5m = $0.9m

NCI share: 40% × $1.5m = $0.6m

Goodwill as at the reporting date is $1 million.

(b) **Specialised plant**

Per IAS 16 *Property, Plant and Equipment* (PPE), items of PPE should be initially recognised at cost. This includes costs directly attributable to getting the asset ready for use. General overheads and training cannot be capitalised and must be written off to profit or loss as incurred. Therefore $4.2m ($3.7m + $0.5m) should be written off to profit or loss.

Dr Profit or loss	$4.2m
Cr PPE	$4.2m

Depreciation should start when the PPE is available for use. As a result of the error above, depreciation for the year will be incorrect.

Depreciation charged on this asset is $1.5m ($15m/5 years × 6/12). Depreciation of $1.1 m (($15m – $4.2m)/5 years × 6/12) should have been charged. This means that depreciation in profit or loss must be reduced by $0.4m. The correcting entry is:

Dr PPE	$0.4m
Cr Profit or loss	$0.4m

Test your understanding 2 – Pineapple

(a) **Sale of shares in Satsuma**

Pineapple controlled Satsuma for the first six months of the reporting period. This means that Pineapple should consolidate Satsuma's results for these six months.

The sale of shares results in Pineapple losing control over Satsuma. The net assets, goodwill and non-controlling interest of Satsuma should therefore be derecognised from the consolidated financial statements. A profit on disposal arises for the difference between these amounts and the consideration received from the disposal.

The profit on disposal is calculated as follows:

	$000	$000	$000
Proceeds from disposal			5,600
Goodwill at disposal:			
Consideration	4,900		
NCI at acquisition	1,600		
FV of net assets at acquisition ($2,000 + $2,045)	(4,045)		
Goodwill at acquisition	2,455		
Impairment (40%)	(982)		
		1,473	
Net assets at disposal:			
Share capital	2,000		
Retained earnings b/fwd	2,342		
Profit to disposal date ($568 × 6/12)	284		
		4,626	
NCI at disposal:			
NCI at acquisition	1,600		
NCI share of post-acquisition net assets (30% × ($4,626 – $4,045))	174		
NCI share of impairment (30% × $982)	(295)		
		(1,479)	
Carrying amount of sub at disposal			(4,620)
Profit on disposal			980

Satsuma is a discontinued operation in accordance with IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* because it is an operationally and geographically distinct part of the business that has been sold during the period. As such, a single figure is presented on the face of the statement of profit or loss in respect of Satsuma, which comprises its profit up to the disposal date and the profit on disposal. This 'profit from discontinued operations' is calculated as follows:

	$000
Profit to disposal date ($568 × 6/12)	284
Profit on disposal	980
	–––––
Profit from discontinued operations	1,264
	–––––

(b) **Financial assets**

According to IAS 32 *Financial Instruments: Presentation*, the loan is a financial asset because Pineapple has a contractual right to receive cash. Pineapple will hold the financial asset to collect the contractual cash flows and so, according to IFRS 9 Financial Instruments, it should be measured at amortised cost.

The financial asset should have been initially recognised at fair value. IFRS 13 *Fair Value Measurement* defines fair value as the price at which an asset would be sold in an orderly transaction between market participants at the measurement date. The price paid of $1,500,000 does not represent the fair value of the asset because market participants (i.e. banks) do not lend money interest-free. The fair value should be calculated as the present value of the future cash flows, discounted using the market rate of interest This amounts to $953,000 ($1,500,000 × ($1/1.12^4$)).

The asset must be written down by $547,000 ($1,500,000 – $953,000), and the loss charged to profit or loss.

Dr Profit or loss	$547,000
Cr Financial asset	$547,000

For financial assets measured at amortised cost, interest income is calculated using the effective rate. This amounts to $114,000 ($953,000 × 12%). It is recognised in profit or loss and increases the carrying amount of the financial asset.

Dr Financial asset	$114,000
Cr Profit or loss	$114,000

At the reporting date the financial asset will have a carrying amount of $1,067,000 ($953,000 + $114,000).

Test your understanding 3 – Vinyl

(a) **Investment in CD**

Goodwill arising on the acquisition of CD is calculated in Marks. IAS 21 *The Effects of Changes in Foreign Exchange Rates* states that it should be treated as an asset of the foreign operation and translated at each reporting date using the closing rate of exchange. Foreign exchange gains or losses arise, which are recorded in other comprehensive income.

The goodwill arising on the acquisition of CD is calculated as follows:

	MKm	MKm
Consideration		360.0
FV of NCI at acquisition		90.0
FV of net assets at acquisition:		
Share capital	76	
Retained earnings	210	
Brand	10	
	–––––	
		(296.0)
		–––––
Goodwill		154.0
		–––––

When translated at the closing rate, goodwill at the reporting date on the consolidated statement of financial position is \$90.6 million (MK154/1.7). At the acquisition date it would have been \$128.3 million (MK154/1.2). As such an exchange loss of \$37.7 million (\$128.3 – \$90.6m) is recorded in other comprehensive income. This must be split between the group and the non-controlling interest because full goodwill was calculated. The group's share of \$28.3 million (75% × \$37.7m) is held in a translation reserve in equity. The NCI's share of \$9.4 million (25% × \$37.7m) is held in the NCI reserve in equity.

A foreign exchange loss also arises on the translation of the opening net assets and profits of CD. This is calculated as follows:

	MKm	Exchange Rate	\$m
Opening net assets	296.0	1.2	246.7
Profit (275 – 210)	65.0	1.4	46.4
Exchange loss	–	Bal. fig.	(80.7)
	–––––		–––––
Closing net assets	361.0	1.7	212.4
	–––––		–––––

The $80.7 million loss is recorded in other comprehensive income. It is split between the group and the NCI based on their respective shareholdings. The group's share of $60.5 million (75% × $80.7m) is held in the translation reserve in equity. The NCI's share of $20.2 million (25% × $80.7m) is recorded in the NCI reserve in equity.

(b) **Convertible bond**

In accordance with IAS 32 *Financial Instruments: Presentation*, the convertible bond should have been split into a liability component and an equity component. The liability component is calculated as the present value of the repayments, discounted using the interest rate on a similar debt instrument without a conversion option. The equity component is the balance of the proceeds.

The repayments are interest of $2m (500,000 × $100 × 4%) per year, plus the repayment of $50m (500,000 × $100) on 30 September 20X7.

Date	**Cash flow**	**Discount rate**	**Present value**
	$m		$m
30/9/X5	2.0	1/1.09	1.8
30/9/X6	2.0	$1/1.09^2$	1.7
30/9/X7	52.0	$1/1.09^3$	40.2
			–––––
Liability			43.7
			–––––

The liability component should have been initially recognised at $43.7m and the equity component should have been recognised at $6.3m ($50m – $43.7). The following adjustment is therefore required:

Dr Non-current liabilities	$6.3m
Cr Other components of equity	$6.3m

Test your understanding 4 – Frank

Cash generated from operations

	$m
Profit before tax	88
Finance cost	12
Share of profit of associates	(21)
Loss on disposal of PPE ($10 – $12)	2
Depreciation (W1)	52
Gain on investment properties (W2)	(8)
Impairment of goodwill (W3)	27
Profit on disposal of subsidiary (W4)	(3)
Increase in inventories ($256 – $201)	(55)
Reduction in receivables ($219 – $263 + $32)	12
Increase in payables ($524 – $486 + $55)	93
Cash generated from operations	199

Workings

(W1) **Property, plant and equipment**

	$m
Bal b/fwd	263
Additions	53
Disposal of PPE	(12)
Revaluation of PPE (OCI)	50
Disposal of subsidiary	(81)
Depreciation (bal. fig.)	(52)
Bal c/fwd	221

(W2) **Investment properties**

	$m
Bal b/fwd	60
Additions	14
Gain in P/L (bal. fig.)	8
Bal c/fwd	82

(W3) **Goodwill**

	$m
Bal b/fwd	142
Disposal of subsidiary	(40)
Impairment (bal. fig.)	(27)
Bal c/fwd	75

(W4) **Disposal of subsidiary**

	$m	$m
Cash proceeds		41
FV of interest retained		32
Goodwill at disposal	40	
Net assets at disposal	34	
NCI at disposal	(4)	
CA of subsidiary at disposal		(70)
Profit on disposal		3

Test your understanding 5 – Sunny Days

(a) **Biological assets**

IAS 41 *Agriculture* states that unconditional government grants related to biological assets are recognised in profit or loss when they become receivable. The government grant of $0.2 million will be recognised immediately in profit or loss because it was unconditional.

At the reporting date, biological assets are remeasured to fair value less costs to sell with gains or losses reported in profit or loss. Fair value is defined as the price that would be received from selling an asset in an orderly transaction amongst market participants at the measurement date. Fair value is determined by reference to the principal market or, in the absence of a principal market, the most advantageous market. The most advantageous market is the market which maximizes the net selling price that an entity will receive.

The principal market cannot be determined so the fair value of the biological assets at year end must be determined with reference to the most advantageous market. The net price received in market 1 is $2.49 million ($2.6m – $0.1m – ($2.6m × 0.5%)). The net price received in market 2 is $2.39 million ($2.8m – $0.4m – ($2.8m × 0.5%)). Market 1 is the most advantageous market and should be used to determine fair value.

The fair value of the herd is therefore $2.5 million ($2.6m – $0.1m) and the fair value less costs to sell is $2.49 million (see calculation above). The herd should be recognized at $2.49 million at the reporting date and a gain of $0.39 million (W1) will be recorded in profit or loss.

Land

The land is an item of property, plant and equipment. Revaluation losses on property, plant and equipment are recorded in profit or loss unless a revaluation surplus exists for that specific asset.

The revaluation on 30 September 20X3 of $0.2 million ($3.2m – $3.0m) would have been recorded in other comprehensive income and held within a revaluation reserve in equity. The downwards revaluation in the current reporting period is $0.5 million ($3.2m – $2.7m). Of this, $0.2 million will be charged to other comprehensive income and the remaining $0.3 million will be charged to profit or loss.

(W1) **Gain on revaluation of biological assets**

	$m
Bfd	1.8
Additions	0.8
Death and disposal	(0.5)
Gain	0.39
Cfd	2.49

(b) To recognise a provision, IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* says that the following criteria must be satisfied:

– There must be a present obligation from a past event

– There must be a probable outflow of economic benefits

– The costs to settle the obligation must be capable of being estimated reliably.

No provision should be recognised for the $0.8 million costs of compliance because there is no obligation to pay (Sunny Days could simply change the nature of its business activities).

A provision should be made for the $0.1 million fine because there will be a probable outflow of resources from a past obligating event (breaking the law).

The fine is not an allowable expense for tax purposes and so the difference between accounting and tax treatments is not temporary. This means that no deferred tax balance is recognised.

(c) A contract contains a lease if it **'conveys the right to control the use of an identified asset for a period of time in exchange for consideration'** (IFRS 16, para 9).

To assess whether this is the case, IFRS 16 *Leases* requires entities to consider whether the customer has:

– the right to substantially all of the identified asset's economic benefits, and

– the right to direct the identified asset's use.

An asset – Unit 5A – is explicitly identified in the contract. Although Sunny Days can be relocated to a different unit, the supplier is unlikely to benefit from this. Therefore Sunny Days has the right to use an identified asset over the contract term.

Sunny Days has the right to substantially all of the economic benefits resulting from the use of the unit. This is because it has exclusive use of Unit 5A for five years, enabling it to make sales and to generate profits. The payments made to the supplier based on the revenue generated are a form of consideration that is transferred in exchange for the right to use the unit.

Sunny Days has the right to direct the use of the unit because it decides what products are sold, and the price at which they are sold. The restrictions on opening times outlined in the contract define the scope of a Sunny Day's right of use, rather than preventing Sunny Days from directing use. The supplier's provision of security and maintenance services has no impact on how Unit 5A is used.

Based on the above, it would seem that the contract between Sunny Days and its supplier contains a lease.

Test your understanding 6 – Coffee

(a) IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* says that a prior period error is a misstatement in prior year financial statements resulting from the misuse of information which should have been taken into account. Prior period errors are adjusted for retrospectively, by restating comparative amounts. Changes in accounting estimates are accounted for prospectively by including the impact in profit or loss in the current period and, where relevant, future periods.

The court case

This is not a prior period error because Coffee had based its accounting treatment on the best information available. The payment of $2 million will be expensed to profit or loss in the year ended 30 September 20X4.

Tax

The mistakes made in the financial statements for the year ended 30 September 20X3 should not have been made based on the information available to Coffee. This therefore satisfies the definition of a prior period error. In the financial statements for the year ended 30 September 20X3 the current tax expense and the income tax payable should both be increased by $1 million.

(b) According to IFRS 9 *Financial Instruments*, an investment in debt should be held at amortised cost if it passes the 'contractual cash flows characteristics' test and if an entity's business model is to hold the asset until maturity. The contractual cash flows characteristics test is passed if the contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

If an entity's business model is to both hold the assets to maturity and to sell the assets, and the asset passes the contractual cash flows characteristics test, then the debt instrument should be measured at fair value through other comprehensive income. All other investments in debt instruments should be measured at fair value through profit or loss.

Coffee's individual financial statements

Coffee regularly sells the financial assets, and therefore does not hold them in order to collect the contractual cash flows. In Coffee's individual financial statements, the financial assets should be measured at fair value at the reporting date with any gains or losses reported in profit or loss.

Consolidated financial statements

IFRS 10 *Consolidated Financial Statements* says that group accounts show the incomes, expenses, assets and liabilities of a parent and its subsidiaries as a single economic entity. Any profit or loss arising on the sale of the assets between Coffee and Tea must be eliminated when producing the consolidated financial statements.

Tea holds the financial assets until maturity. Therefore, the financial assets are held within the Coffee group in order to collect the contractual cash flows. In the consolidated financial statements of the Coffee group, the financial assets should be measured at amortised cost. Assuming that credit risk is low at the reporting date, a loss allowance must be created equal to 12-month expected credit losses.

The group could designate the financial assets to be measured at fair value through profit or loss if it reduces an accounting mismatch that arises from recognising gains or losses on different bases.

(c) IAS 7 *Statement of Cash Flows* defines 'cash equivalents' as **'short term, highly liquid investments that are readily convertible to a known amount of cash and which are subject to an insignificant risk of a change in value'** (IAS 7, para 6).

The gold bullion is held for investment purposes, not for the purpose of meeting short-term cash commitments. There is also a substantial risk that the gold will go up or down in value and therefore it is not convertible to a known amount of cash. The gold bullion must therefore be excluded from cash and cash equivalents in the statement of cash flows. The money spent on the gold bullion would most likely be presented within cash flows from investing activities.

(d) In accordance with IAS 38 *Intangible Assets,* purchased intangible assets are initially measured at cost. The customer list will therefore be initially recognised at its cost of $2 million.

Expenditure on internally generated intangible assets (except those arising from development activities) cannot be distinguished from the cost of developing the business as a whole. Such items are not recognised as intangible assets. The enhancement to the list is internally generated and consequently cannot be recognised.

Intangible assets can only be held under a revaluation model if an active market exists. The customer list is bespoke and so no active market will exist. Therefore, it cannot be held at fair value.

The customer list should be amortised over its estimated useful life of 18 months. This is the period over which the benefits of the $2 million expenditure will be realised. The amortisation expense in profit or loss in the current period is $1.3 million ($2m × 12/18) and the carrying amount of the intangible at the reporting date is $0.7 million ($2m – $1.3m).

Test your understanding 7 – Bath

(a) According to IFRS 8 *Operating Segments*, an entity must report information about an operating segment if its:

– total revenue (internal and external) is 10% or more of the combined revenue of all segments

– reported profit or loss is more than 10% of the greater, in absolute amount, of (i) the combined reported profit of all operating segments that did not report a loss and (ii) the combined reported loss of all operating segments that reported a loss, or

– assets are 10% or more of the combined assets of all operating segments.

If total external revenue reported by operating segments is less than 75% of the entity's total revenue, additional operating segments must be identified as reportable.

Revenue

All segments with total revenue of greater than $60.9 million (10% × $609m) must be reported.

Delivery Services and Vehicle Hire pass this test.

Reported profit or loss

The total profit of the profit making segments is $87 million ($62m + $14m + $8m + $3m). The total loss of the loss making segments is $10 million. 10% of the greater is therefore $8.7 million (10% × $87m). This means that segments with a profit or loss of greater than $8.7 million must be reported.

Delivery Services, Vehicle Hire and Removal Services pass this test.

Assets

All segments with total assets of greater than $49.6 million (10% × $496m) must be reported.

Delivery Services, Vehicle Hire and Removal Services pass this test.

75% test

Based on the above three tests, Delivery Services, Vehicle Hire and Removal Services are reportable. Together, their external revenue is $423 million ($281m + $96m + $46m). This amounts to 93.6% ($423m/$452m) of Bath's external revenue. Therefore, no other segments need to be reported.

(b) According to IFRS 15 *Revenue from Contracts with Customers,* an entity should recognise revenue when (or as) the entity satisfies a performance obligation by transferring a promised good or service to a customer. Entities must decide at the inception of a contract whether a performance obligation is satisfied over time or at a point in time.

An entity transfers control of a good or service over time and, therefore, satisfies a performance obligation and recognises revenue over time, if one of the following criteria is met:

– **'the customer simultaneously receives and consumes the benefits provided by the entity's performance as the entity performs**

– **the entity's performance creates or enhances an asset that the customer controls as the asset is created or enhanced, or**

– **the entity's performance does not create an asset with an alternative use to the entity and the entity has an enforceable right to payment for performance completed to date'** (IFRS 15, para 35).

The recovery service is consumed as time passes, since the service for a prior month cannot be re-performed again in the future. Revenue should therefore be recognised over time, rather than upfront.

An output method based on the time that has elapsed on the contract would probably provide the best estimate of the amount of revenue to recognise.

(c) Per IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*, an asset is classified as held for sale if it is available for immediate sale in its present condition and the sale is highly probable. To be highly probable, there must be an active plan to find a buyer, the asset must be being marketed at a price that is reasonable in relation to its fair value, and the sale should be expected within 12 months. An asset that is classified as held for sale should be measured at the lower of its carrying amount and fair value less costs to sell.

On 30 September 20X4 the sale appeared to be highly probable as the building was being marketed at its fair value. The carrying amount of the asset at 30 September 20X4 was $16 million ($20m × (40/50)). This is lower than the fair value less costs to sell of $16.9 million ($17m – $0.1 m). Therefore, the asset should continue to be held at $16m.

The rise in interest rates occurs after the end of the reporting period. Therefore, the decline in the asset's fair value does not represent conditions that existed at the reporting date. This is a non-adjusting event. The asset will remain classified as held for sale in the financial statements for the period ended 30 September 20X4. The decline in the asset's value should, however, be described in a disclosure note.

(d) In accordance with IFRS 9 *Financial Instruments*, financial assets measured at fair value through other comprehensive income are remeasured to fair value each reporting date with the gain or loss recorded in other comprehensive income (OCI).

IFRS 13 *Fair Value Measurement* defines fair value as the price received when selling an asset in an orderly transaction amongst market participants at the measurement date. When determining fair value, priority is given to level 1 inputs, which are quoted prices for identical assets in active markets. Management's estimate of the dividends that will be received from the shares is a level 3 input to the fair value hierarchy. This should not be used to determine fair value because a level 1 input exists (a quoted price for an identical asset).

The shares should be revalued to $20 million and a gain of $4 million ($20m – $16m) recognised in OCI. The gain in OCI should be classified as an item that will not be recycled to profit or loss in future periods. The dividend received of $3 million is recognised in profit or loss.

According to IAS 12 *Income Taxes*, deferred tax should be calculated on the difference between the carrying amount of a revalued asset and its tax base, even if there is no intention to dispose of the asset. The temporary difference of $4 million ($20m – $16m) will give rise to a deferred tax liability of $1 million ($4m × 25%). The gain on the investment was recognised in OCI and therefore the deferred tax charge will also be recognised in OCI.

Test your understanding 8 – Integrated Reporting

(a) (i) There are many limitations of financial reporting. These include the following:

Historical information

The statement of profit or loss shows the performance of the entity over the past reporting period. This offers little insight into the future. Moreover by the time financial statements are published, the information presented will be several months out of date.

Unrecognised assets/liabilities

Some assets and liabilities are not recognised in financial statements prepared using IFRS Standards, thus limiting usefulness. IFRS Standards prohibit the recognition of Internally generated goodwill. This means that no asset is recognised in respect of the company's reputation or employee skills even though these may play a pivotal role in its success.

Clutter

Financial reports have been criticised in recent years for becoming increasingly cluttered as a result of extensive disclosure requirements. These disclosures are often generic and boilerplate in nature and make it more difficult for the users to find relevant information.

Financial/non-financial information

Current and past profits and cash flows are not the only determinate of future success. Long-term success is also dependent on how an entity is governed, the risks to which it is exposed and how well these are managed, and whether its business activities are sustainable into the medium and long-term. Financial statements prepared in accordance with IFRS Standards say little about these areas.

Estimates

Financial reporting uses many estimates (for instance, depreciation rates). Estimates are subjective and could be manipulated in order to achieve particular profit targets. The subjective nature of estimates reduces comparability between companies.

The statement of cash flows somewhat compensates for the impact of accounting estimates. However, the cash position of an entity can be window-dressed (such as by delaying payments to suppliers).

Use of historical cost

Some accounting standards, such as IAS 16 Property, Plant and Equipment, permit assets to be measured at historical cost. In times of rising prices, the statement of profit or loss will not show a sustainable level of profit. Some standards, such as IAS 16 and IAS 40 Investment Properties, allow entities to choose between cost and fair value models. This makes it harder for stakeholders to compare companies.

(ii) **Purpose**

An Integrated Report is defined as a 'concise communication about how an organisation's strategy, governance, performance and prospects, in the context of its external environment, lead to the creation of value in the short, medium and long term'. Value is conceptualised in terms of a range of capitals, not just financial. Integrated Reporting is therefore based on the premise that maximizing financial capital at the expense of other capitals (such as human, social and natural) is not sustainable in the longer term.

The key users of an Integrated Report are deemed to be the providers of financial capital. The Integrated Report will help these users to assess the long-term performance and continuation of the entities that they invest in.

Content

The Framework for Integrated Reporting is principles based and therefore it does not prescribe KPIs to be disclosed.

An Integrated Report should cover the following elements:

– **Organisational overview and external environment** – 'What does the organisation do and what are the circumstances under which it operates?'

– **Governance** – 'How does the organisation's governance structure support its ability to create value in the short, medium and long term?'

– **Opportunities and risks** – 'What are the specific opportunities and risks that affect the organisation's ability to create value over the short, medium and long term, and how is the organisation dealing with them?'

– **Strategy and resource allocation** – 'Where does the organisation want to go and how does it intend to get there?'

- **Business model** – 'What is the organisation's business model and to what extent is it resilient?'
- **Performance** – 'To what extent has the organisation achieved its strategic objectives and what are its outcomes in terms of effects on the capitals?'
- **Future outlook** – 'What challenges and uncertainties is the organisation likely to encounter in pursuing its strategy, and what are the potential implications for its business model and future performance?'
- **Basis of presentation** – 'How does the organisation determine what matters to include in the integrated report and how are such matters quantified or evaluated?'

The exact content of these elements is judgemental. Management should include material issues and justify their decisions.

(iii) Integrated Reports focus on value creation in the medium and long-term. They are much more forward-looking than financial reporting and will therefore help user groups in the decision making process. Financial reporting conceptualises value in terms of profits and cash. Integrated Reporting takes a much wider more holistic view of an entity than financial reporting. This may be of particular use for those who wish to invest in 'sustainable' entities.

Issues of governance and risk are very prominent within Integrated Reports, but are often missing from financial reports. These are key determinants of future success.

Employee skills and expertise are often neglected in financial reporting, but form a prominent part of Integrated Reports.

However, there are issues not addressed by Integrated Reporting. Assessments of materiality and KPIs are subjective and so it will be difficult to compare the Integrated Reports of two different companies. Preparers of Integrated Reports may still let bias influence the report's content. This is particularly true if no assurance is provided on the report. Some may also view Integrated Reports as another form of 'clutter' and be overwhelmed by the quantity of information they are presented with.

(b) According to IAS 38 *Intangible Assets*, an entity usually has insufficient control over the expected future economic benefits arising from a team of skilled staff and from training to meet the definition of an intangible asset. This means that money spent on employee training is expensed to profit or loss. Because no asset is recognised in relation to employee expertise, users are unaware of its value.

Employees are likely to be TinCan's greatest asset and details of this will be pivotal to any assessment of TinCan's long-term success. An Integrated Report conceptualises value in terms of a range of capitals, including human capital (i.e. employees). Therefore TinCan would make extensive disclosures about its staff.

TinCan's commitment to staff training would be disclosed as leading to a net increase in human capital. This human capital should eventually lead to an even greater increase in financial capital. KPIs, such as details of expenditure on staff training, would enable users to assess and compare TinCan's commitment to its staff over time. TinCan could also include KPIs covering staff turnover and staff pay to help the users compare these to industry averages. Disclosure of its investment in employees in an Integrated Report is likely to lead to stakeholder confidence about TinCan's likely performance in the medium to long-term.

TinCan should also disclose any risks that may threaten the sustainability of its business model and how those risks are being managed. For instance, TinCan faces the risk that other companies may try to recruit its employees through offers of higher pay. Similarly, it is possible that TinCan will lose market share as its competitors, who may pay lower staff salaries, develop cheaper alternative products.

These disclosures in the Integrated Report will help users to ascertain the sustainability of TinCan's business model, potentially encouraging the providers of financial capital to invest.

Chapter

27

References

This document references IFRS Standards and IAS Standards, which are authored by the International Accounting Standards Board (the Board), and published in the 2022 IFRS Standards Red Book.

The Board (2022) *Conceptual Framework for Financial Reporting*. London: IFRS Foundation.

The Board (2022) IAS 1 *Presentation of Financial Statements.* London: IFRS Foundation.

The Board (2022) IAS 2 *Inventories*. London: IFRS Foundation.

The Board (2022) IAS 7 *Statement of Cash Flows*. London: IFRS Foundation.

The Board (2022) IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors.* London: IFRS Foundation.

The Board (2022) IAS 10 *Events after the Reporting Period.* London: IFRS Foundation.

The Board (2022) IAS 12 *Income Taxes.* London: IFRS Foundation.

The Board (2022) IAS 16 *Property, Plant and Equipment.* London: IFRS Foundation.

The Board (2022) IAS 19 *Employee Benefits.* London: IFRS Foundation.

The Board (2022) IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance.* London: IFRS Foundation.

The Board (2022) IAS 21 *The Effects of Changes in Foreign Exchange Rates.* London: IFRS Foundation.

The Board (2022) IAS 23 *Borrowing Costs.* London: IFRS Foundation.

The Board (2022) IAS 24 *Related Party Disclosures.* London: IFRS Foundation.

The Board (2022) IAS 27 *Separate Financial Statements.* London: IFRS Foundation.

The Board (2022) IAS 28 *Investments in Associates and Joint Ventures.* London: IFRS Foundation.

The Board (2022) IAS 32 *Financial Instruments: Presentation.* London: IFRS Foundation.

The Board (2022) IAS 33 *Earnings per Share.* London: IFRS Foundation.

The Board (2022) IAS 34 *Interim Financial Reporting.* London: IFRS Foundation.

The Board (2022) IAS 36 *Impairment of Assets.* London: IFRS Foundation.

The Board (2022) IAS 37 *Provisions, Contingent Liabilities and Contingent Assets.* London: IFRS Foundation.

The Board (2022) IAS 38 *Intangible Assets.* London: IFRS Foundation.

The Board (2022) IAS 40 *Investment Property.* London: IFRS Foundation.

The Board (2022) IAS 41 *Agriculture*. London: IFRS Foundation.

The Board (2022) IFRS 1 *First-time Adoption of International Financial Reporting Standards.* London: IFRS Foundation.

The Board (2022) IFRS 2 *Share-based Payment.* London: IFRS Foundation.

The Board (2022) IFRS 3 *Business Combinations.* London: IFRS Foundation.

The Board (2022) IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations.* London: IFRS Foundation.

The Board (2022) IFRS 7 *Financial Instruments: Disclosure.* London: IFRS Foundation.

The Board (2022) IFRS 8 *Operating Segments.* London: IFRS Foundation.

The Board (2022) IFRS 9 *Financial Instruments.* London: IFRS Foundation.

The Board (2022) IFRS 10 *Consolidated Financial Statements.* London: IFRS Foundation.

The Board (2022) IFRS 11 *Joint Arrangements.* London: IFRS Foundation.

The Board (2022) IFRS 12 *Disclosure of Interests in Other Entities.* London: IFRS Foundation.

The Board (2022) IFRS 13 *Fair Value Measurement.* London: IFRS Foundation.

The Board (2022) IFRS 15 *Revenue from Contracts with Customers.* London: IFRS Foundation.

The Board (2022) IFRS 16 *Leases*. London: IFRS Foundation.

The Board (2015) *IFRS for SMEs Standard*. London: IFRS Foundation.

The Board (2022) *IFRS Practice Statement: Management Commentary.* London: IFRS Foundation.

The Board (2022) *IFRS Practice Statement: Making Materiality Judgements.* London: IFRS Foundation.

12-month expected credit loss.....276

A

Accounting
  estimate.....51
  policy.....50

Accruals basis.....44

Acquisition
  date.....408
  method.....407

Active market.....17

Additional performance measures.....561

Adjusting events.....238, 239

Agents.....62

Aggregation.....13, 44, 345

Agriculture.....130
  produce.....130, 132

Allocate the transaction price.....65

Amortisation.....99

Amortised cost.....262, 263, 272, 273

Artificial intelligence.....31

Assessing financial performance and position.....549

Asset.....8
  ceiling.....194

Associate.....356, 391, 463, 521

AVCO.....134

B

Background.....3

Bargain purchase.....412

Basic EPS.....552

Biological asset(s).....130

Bonus
  fraction.....553
  issues.....553

Borrowing costs.....91

Business.....404
  combinations.....404
  combinations and deferred tax.....332, 334
  model.....272, 572

C

Cancellations.....220

Capitals.....572

Cash
  equivalents.....510
  flow hedge.....288, 291
  flows from financing activities.....507, 509
  flows from operating activities.....507
  generating unit(s).....105, 413
  settled share-based payments.....213, 221

Chief operating decision maker.....345

Classification of financial liabilities and equity.....260

Close members of family.....357

Code of ethics and conduct.....29

Companies Act.....618

Comparability.....6

Comparative information.....45

Compound instruments.....267

Concentration test.....405

Conceptual Framework.....30, 40, 41, 43, 51, 52, 85, 86, 187, 242, 243, 275, 284, 376, 386, 403, 505

Confidentiality.....29

Consolidated
  financial statements.....385
  statement of cash flows.....516
  statement of financial position.....386
  statement of profit or loss and other comprehensive income.....389

Consolidation of a foreign operation.....482

Constructive obligation.....241

Content of an integrated report.....573

Contingent
  asset.....244
  liability.....243

Contract
  costs.....71
  modifications.....70

Contractual cash flows.....272

Control.....68, 357, 403

Control to control.....457

Cost
  constraint.....7
  model.....86, 93, 98

Credit
  impaired.....278, 279
  loss.....276
  risk.....276

Criteria for hedge accounting.....288

Cryptocurrency.....587

Current
  asset.....39
  issues.....587
  liability.....39
  service cost.....186
  tax.....318, 319

Curtailment.....186, 193

D

Date of transition.....369

Debt and equity.....260

Deductible temporary difference.....323

Deferred tax.....318, 319, 324, 326

Defined
  benefit.....183, 185, 193
  contribution.....183, 184

Derecognition.....10, 88, 243, 281

Derivatives.....283

Development.....100

Diluted EPS.....556

Direct method.....507

Disclosure(s).....12, 45, 592
 of financial instruments.....295
 isclosure of related parties.....359

Discontinued operation.....47, 455

Discontinuing hedge accounting.....294

Disposal
 group.....111
 of a foreign subsidiary.....494
 scenarios.....450

E

Economic resource.....9

Effective rate of interest.....262

Elements.....8

Embedded derivatives.....286

Enhancing characteristics.....6

Environmental provisions.....246

Equity.....8, 259
 method.....392, 422
 settled share-based payments.....213, 327

Ethics.....28, 568

Events after the reporting period.....238

Examinable differences between International and UK standards.....606

Exchange difference(s).....142, 143, 486, 531

Executory contract.....283

Exemptions from consolidation.....418

Expected credit loss.....276

Expenses.....9

F

Fair value.....16, 102
 hedge.....288
 through other comprehensive income.....270, 272, 273, 280
 through profit or loss.....265, 270, 272, 273

Faithful representation.....6

FIFO.....134

Finance lease.....164.....165

Financial
 asset.....259, 270, 272, 281
 instrument.....259
 liability.....259, 261, 281
 statements.....7

First-time
 adopter.....368
 adoption.....368

FRS 100 *Application of Financial Reporting Requirements*.....602

FRS 101 *Reduced Disclosure Framework*.....603

FRS 102 *The Financial Reporting Standard Applicable in the UK and the Republic of Ireland*.....602, 604

FRS 105 *The Financial Reporting Standard Applicable to the Micro-Entities Regime*.....602

Functional currency.....140, 482

Fundamental characteristics.....6

Future operating losses.....244

G

Going concern.....43, 240

Goodwill.....388, 410, 412, 413, 485
 translation.....486

Government
 assistance.....89
 grants.....89, 133
 related entities.....360

Grant date.....214

Group
 reorganisation.....464
 share-based payments.....225

H

Harvest.....130

Hedge
 accounting.....287
 effectiveness.....293

Hedged item.....287

Hedging instrument.....287

Held for sale.....47, 111, 461

Highest and best use.....19

I

IAS 1 *Presentation of Financial Statements*.....38, 39

IAS 2 *Inventories*.....133

IAS 7 *Statement of Cash Flows*.....505

IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.....50

IAS 10 *Events after the reporting period*.....238

IAS 12 *Income Taxes*.....318

IAS 16 *Property, Plant and Equipment*.....84

IAS 19 *Employee Benefits*.....182

IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*.....89

IAS 21 *The effects of changes in foreign exchange rates*.....140

IAS 23 *Borrowing Costs*.....91

IAS 24 *Related Party Disclosures*.....354

IAS 27 *Separate Financial Statements*.....425, 464

IAS 28 *Investments in Associates and Joint Ventures*.....391, 422

IAS 32 *Financial Instruments: Presentation*.....259
IAS 33 *Earnings per Share*.....551
IAS 34 *Interim Financial Reporting*.....52
IAS 36 *Impairment of Assets*.....102, 413
IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.....241
IAS 38 *Intangible Assets*.....97
IAS 40 *Investment Property*.....92
IAS 41 *Agriculture*.....130
Identifiable assets and liabilities.....408
Identifying the acquirer.....407
IFRS 1 *First Time Adoption of International Financial Reporting Standards*.....368
IFRS 2 *Share-based Payment*.....212
IFRS 3 *Business Combinations*.....421, 425
IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*.....47, 111, 455, 461
IFRS 7 *Financial Instruments: Disclosures*.....295
IFRS 8 *Operating Segments*.....344
IFRS 9 *Financial Instruments*.....261, 270, 272, 276
IFRS 10 *Consolidated Financial Statements*.....385, 403
IFRS 11 *Joint Arrangements*.....420
IFRS 12 *Disclosure of Interests in Other Entities*.....425
IFRS 13 *Fair Value Measurement*.....16
IFRS 15 *Revenue from Contracts with Customers*.....58
IFRS 16 *Leases*.....156
Impairment.....102
  of financial assets.....276
  of goodwill.....413
Income.....9
Increasing a shareholding in a subsidiary.....458
Indications of impairment.....102
Indirect method.....507
Initial coin offerings.....588
Inputs.....405
Insider trading.....30
Intangible asset.....97
Integrated reporting.....569, 571
Integrity.....29
International Integrated Reporting Council.....571
Inventories.....133
Investment(s)
  entities.....419
  property.....92
  in debt instruments.....272
  in equity instruments.....270
Investor perspective.....20, 49, 58, 96, 199, 225, 251, 261, 289, 348, 360, 361, 371, 376, 508, 551, 562, 563

J

Joint
  arrangements.....420
  control.....357, 420
  operations.....421
  venture(s).....356, 421

K

Key management personnel.....357, 359

L

Lease.....156
  liability.....158
  term.....159
Leases.....328
Lessee.....156
  accounting.....158
Lessor accounting.....164
Lessor.....156
Liability.....8
Lifetime expected credit loss.....276
Liquidity.....550
Long-term financial stability.....550
Loss allowance.....276
Low value assets.....163

M

Management commentary.....594
Market
  condition.....216
  participants.....16
Materiality.....44, 591
Measurement.....11, 86, 93
  period.....413
Micro-entity.....603
Mid-year acquisition.....442
Monetary.....143
Most advantageous market.....18

N

Natural disasters.....589
Net interest component.....186
Net realisable value.....134
Non-adjusting events.....238, 239
Non-controlling interest.....389, 412, 414, 519
Non-financial
  assets.....19
  performance measures.....566
Non-market performance conditions.....216
Not-for-profit entities.....575

O

Objectivity.....29
Offsetting.....45, 261
Omissions from the SMEs Standard.....377
Onerous contracts.....245
Opening net assets and profit.....487
Operating
  lease.....164, 166
  segment.....344, 346
Other comprehensive income.....13, 40, 47, 187
Other long-term benefits.....198
Outputs.....405

P

Parent.....385
Past service cost.....186
Performance conditions.....61, 216
Practice Statement
  Making Materiality Judgements.....592
  Management Commentary.....594
Presentation.....12, 267, 592
  currency.....141, 482
  of disposed subsidiary.....455
Principal market.....18
Principals.....62
Principles.....28
Prior period errors.....51
Processes.....405
Professional behaviour.....29
Professional competence and due care.....29, 30
Profitability.....549
Property, plant and equipment.....84
Provisions.....241
Purchase consideration.....410

Q

Qualifying asset.....91
Qualitative characteristics.....6

R

Reclassification.....46
  of financial assets.....273
Recognition.....9, 84, 89, 91, 98, 130, 131, 241, 261, 270, 324, 592
Recoverable amount.....102, 413
Related party.....355
  transaction.....354
Relevance.....6
Remeasurement component.....187
Reporting entity.....8
Research.....100
  and development.....100
Restructuring.....248
Revaluation model.....86, 98
Revenue.....58
  recognition.....59
Reversal of an impairment loss.....108
Right-of-use asset.....156, 159
Rights issues.....554

S

Sale and leaseback.....167
Sale of shares without losing control.....459
Segmental reports.....344
Service cost component.....186
Settlement.....186, 193
Share appreciation rights.....221
Share-based payment(s).....212
  hybrid transactions.....224
Short-term employee benefits.....196
Significant influence.....357
Simplifications in the SMEs Standard.....378
Small and medium sized entities.....376
Statement(s) of
  cash flows.....504, 505, 560
  of changes in equity.....42
  of profit or loss and OCI.....41
Step acquisition.....446
Subsidiary.....356
Sustainability reporting.....568, 596

W

Tax base.....320, 323
Taxable temporary difference.....323
Taxation.....318
Tech companies.....564
Temporary difference.....320, 322
Termination benefits.....197
The Global Reporting Initiative.....569
The International Integrated Reporting Council.....569
The SMEs Standard.....377
The United Nations Global Compact.....569
Timeliness.....6
Total comprehensive income.....40
Translating an overseas subsidiary.....483
Translating goodwill.....485

U

UK GAAP.....602
Understandability.....6
Unremitted earnings.....333
Unused tax losses.....331

V

Value.....573

in use.....103

Variable consideration.....63

Verifiability.....6

Vesting date.....214

W

Warranties.....63