MARK PLAN AND EXAMINER'S COMMENTARY

The marking plan set out below was that used to mark this question. Markers were encouraged to use discretion and to award partial marks where a point was either not explained fully or made by implication. More marks were available than could be awarded for each requirement. This allowed credit to be given for a variety of valid points which were made by candidates.

Question 1

Total Marks: 31

Part 1.1 of this question tested the preparation of a statement of profit or and a statement of financial position from a list of balances plus a number of adjustments. Adjustments related to an impairment of a previously revalued asset, a finance lease, foreign exchange transactions, an intangible asset and an under-provision for income tax. Part 1.2 required a discussion of the ethical issues arising from the scenario and the action to be taken.

1.1 Penne Ltd

Statement of profit or loss for the year ended 30 June 2018			**Marks**
	£		1 Pres
Revenue	6,256,800		½ Ab
Cost of sales (W1)	(3,724,280)		
Gross profit	2,532,520		
Operating expenses (W1)	(2,005,500)		
Operating profit	527,020		
Finance costs (3,516 + 3,207) (W4)	(6,723)		½ (OF)
Profit before tax	520,297		
Income tax (53,500 + 1,200)	(54,700)		1
Profit for the year	465,597		

Statement of financial position as at 30 June 2018			
	£	**£**	1 Pres
ASSETS			
Non-current assets			
Property, plant and equipment (W2)		1,254,700	½ (OF)
Intangible assets (W6)		143,750	½ (OF)
		1,398,450	
Current assets			½ for OBs
Inventories (256,800 + 47,500)	304,300		½ (OF)
Trade and other receivables (586,250 – 1,200)	585,050		½ Ab
Cash and cash equivalents	10,100		
		899,450	
Total assets		2,297,900	
Equity			
Ordinary share capital	75,000		½ for OBs
Revaluation surplus (305,200 – 20,000 (W3))	285,200		½ (OF)
Retained earnings (857,550 + 465,597)	1,323,147		½ (OF)
		1,683,347	
Non-current liabilities			
Finance lease liabilities (W4)		50,866	½ (OF)
Current liabilities			
Trade and other payables (498,700 – 5,000 (W5))	493,700		½ (OF)
Finance lease liabilities (67,353 – 50,866) (W4)	16,487		½ (OF)
Taxation	53,500		½ Ab
		563,687	
Total equity and liabilities		2,297,900	

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Workings

(1) Allocation of expenses

	Cost of sales £	Operating expenses £	
Per TB	3,983,900	2,005,500	½
Adjustment for impairment (88,400 Ab – 28,400 OF (W3))	(60,000)		1 ½ Ab
Adjustment for leased asset (9,685 x 2)	(19,370)		½ (OF)
Depreciation on leased asset (W2)	16,000		1
Additional closing inventories (100,000/2 x 0.95) *(95,000) ½*	(47,500)		½ (OF) ½ (OF)
Exchange gain (W5) *Either column*	(5,000)		½ (OF)
Costs now capitalised (W6)	(150,000)		
Amortisation	6,250		
	3,724,280	2,005,500	

(2) Property, plant and equipment

	£	
Carrying amount per TB	1,150,700	½
Adjustment for impairment (88,400 Ab – 48,400 OF (W3))	40,000	1
Finance lease asset	80,000	½ (OF)
Less: Depreciation on leased asset (80,000 ÷ 5)	(16,000)	½ (OF)
	1,254,700	

(3) Impairment

	Property £	Revaluation surplus £	
Cost on 1 July 2015	100,000		
Depreciation y/e 30 June 2016 (100,000/5)	(20,000)		
Carrying amount on 30 June 2016	80,000		½ Ab
Revaluation on 1 July 2016	120,000	40,000	½ (OF)
Depreciation y/e to June 2018 (120,000/4 x 2)	(60,000)		½ (OF)
Transfer to retained earnings to 30 June 2018 (40,000/4 x 2)		(20,000)	½ (OF)
Carrying amount on 30 June 2018	60,000	20,000	
Recoverable amount on 30 June 2018	(11,600)		½ Ab
Total impairment	48,400		
Charge to revaluation surplus	(20,000)	(20,000)	½ (OF)
Charge to profit or loss	28,400	-	

(4) Finance lease *Alt figs where they think 5% is pa*

Six m/e	B/f £	Payment £	Capital £	Interest accrued @ 5% £	C/f £	
31/12/17	80,000 *½*	(9,685)	70,315	3,516 *½ 1,758*	73,831	
30/6/18	73,831	(9,685) *½*	64,146 *62,388*	3,207 *½ 1,560*	67,353 *63,948*	
31/12/18	67,353	(9,685)	57,668 *54,623*	2,883 *½ 1,357*	60,551 *55,620*	3
30/6/19	60,551	(9,685) *½*	50,866 *45,935*			

(5) Foreign exchange

	£	
Translation on 15 June 2018 (100,000 x 0.95)	95,000	½
Translation on 30 June 2018 (100,000 x 0.90)	(90,000)	½
Exchange gain *Give ½ if loss/treated as loss, 2,500 = ½*	5,000	

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(6) Intangible asset	£	
Product development (240,000 x 5/8) *½ for cap 240,000, ½ for 5/8*	150,000	
Less: Amortisation (150,000 ÷ 4 ½ x 2/12 ½)	(6,250)	
	143,750	1
		1 (OF)
Total possible marks		26½
Maximum full marks		26

1.2 Ethical issues	Marks
Both myself and Giorgio are ICAEW Chartered Accountants so should comply with the ICAEW Code of Ethics. By telling his friend about the sale of the shares in Penne Ltd, ie giving him information which is not in the public domain, Giorgio has breached the fundamental principle of confidentiality, by disclosing information acquired as the result of business/professional relationships. There is no indication that the brothers have given Giorgio permission to disclose this information.	½ ½ ½ ½ ½ ½
Furthermore, it appears from the quote that Giorgio will try and reduce the profit for the current financial year, so as to keep the price of the shares down for his friend. In return Giorgio expects his friend to "look on me favourably". This shows a self-interest threat and that Giorgio has breached the fundamental principle of objectivity in his preparation of the financial statements. The net effect of correcting the "errors" Giorgio has made is to more than double the profit for the year, adding weight to the theory that Giorgio has deliberately misstated profits. All of the above indicates that Giorgio is not acting with integrity.	½ ½ + ½ ½ ½ ½ ½
These errors could be genuine, but all the issues are straightforward, and are not subjective, so if Giorgio has made genuine errors then he has breached the fundamental principle of professional competence and due care.	½ + ½ ½
There appear to be intimidation and self-interest and threats for myself, due to Giorgio's statement that he "does not expect" me to find any errors and will reward me with a salary increase if I support the draft financial statements.	½ + ½ ½ ½
I should take the following steps:	
• Discuss each of the errors found with Giorgio, explaining the correct financial reporting treatment to him.	½
• If Giorgio's knowledge appears to be out of date, tactfully suggest that he goes on an update course.	½
• Ensure the financial statements are corrected.	½
• If necessary, seek the support of the manging director/the board/the brothers.	½
• Document all discussions.	½
• If I find myself in a difficult situation, or caught between Giorgio and the brothers, consult the ICAEW helpline.	½
Total possible marks	13
Maximum full marks	5

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Question 2

Total Marks: 32

Part 2.1 of this question required candidates to explain the financial reporting treatment of four accounting issues given in the scenario. The issues covered a joint venture, an equity instrument, borrowing costs and a revenue grant. Part 2.2 required the calculation of a revised figure for consolidated profit for the year. Part 2.3 required a description of the differences between IFRS and UK GAAP in respect of the four issues.	
2.1 Rigatoni Ltd	**Marks**
(1) Joint venture	**(10½)**
Rigatoni Ltd should recognise its investment in Spaghetti Ltd as a joint venture. The two companies have joint control over Spaghetti Ltd and there is a contractual agreement in place to share profits equally and unanimous consent is required for all key operating decisions.	½ ½ + ½ ½
IFRS 11, Joint Arrangements, requires the use of the equity method to account for joint ventures. The investment should initially be recognised at its cost of £50,000 as a non-current asset. This will then be increased by Rigatoni Ltd's share of the joint venture's post acquisition increase in net assets ie initially by £7,800 (15,600 x 50%). The £7,800 will be shown in the consolidated statement of profit or loss as a single line "Share of profit of joint venture"/take share of profit of joint venture to consolidated statement of profit or loss.	½ ½ + ½F + ½ ½ ½F ½ + ½
However, an adjustment is required to remove any unrealised profit between a venturer and the joint venture. The unrealised profit relating to Rigatoni Ltd of £500 (5,000 x 25/125 x 50%) should be removed from Rigatoni Ltd's profit for the year and from the investment in Spaghetti Ltd.	½ ½ + 1F ½ + ½
The "Investment in joint venture" shown as a single line in the consolidated statement of financial position as at 30 June 2018 will therefore be £57,300 (50,000 + 7,800 – 500).	½ + ½ ½ (OF)
(2) Financial instruments	**(4)**
Per IAS 32, Financial Instruments: Presentation, the share issue is a financial instrument, being a contract which give rise to a financial asset of one entity and a financial liability or equity instrument of another entity.	½ ½
The ordinary shares issued are an equity instrument, being a contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities.	½ ½
IFRS 13, Fair Value Measurement, the shares should be recognised at consideration received/proceeds. £75,000 will therefore be recognised as ordinary share capital and £15,000 in share premium. This will clear out the suspense account/Dr suspense account.	½ ½ ½ + ½
(3) Borrowing costs	**(15½)**
Per IAS 23, Borrowing Costs, directly attributable borrowing costs relating to qualifying assets should be capitalised. As the loan was taken out specifically for the purpose of funding the construction of the warehouse the actual interest rate of 6% should be used.	½ + ½ ½ + ½ ½
Capitalisation of borrowing costs should commence when the entity meets all three of the following conditions:	½ ½ for the 3 conditions
• It incurs expenditure on the asset (met on 1 August 2017 when the first construction payment was made). • It incurs borrowing costs (met on 1 July 2017 when the loan was taken out). • It undertakes activities that are necessary to prepare the asset for its intended use (met on 1 August 2017 when construction began).	½ ½ ½

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The three conditions are therefore met on 1 August 2017 so capitalisation should commence on that date. It should cease when the asset is ready for use, ie on 1 June 2018, so borrowing costs of £10,000 (200,000 x 6% x 10/12) should be capitalised. The remaining £2,000 (200,000 x 6% x 2/12) should be expensed. This has been done since the net interest was recognised in profit or loss.	½ ½ + ½ 1 + ½ (OF) ½ ½
Any temporary investment income earned before capitalisation commences should be recognised as part of profit or loss for the period. This is the income earned in the one month before capitalisation begins, so £333 (200,000 x 2% x 1/12). This has already been taken to statement of profit or loss for the year as part of the net interest recognised therein.	½ 1 (OF) ½
The borrowing costs capitalised should be reduced by the investment income received on the invested funds during the capitalisation period. This is the income earned between 1 August 2017 and 30 April 2018, so £1,200 ((200,000 – 120,000) x 2% x 9/12)	½ 1 (OF)
Therefore the total interest capitalised should be £8,800 (10,000 – 1,200).	½ (OF)
Since the warehouse was ready for use on 1 June 2018 it should have been transferred out of assets in the course of construction and into property at a cost of £208,800 (200,000 + 8,800).	½ ½ (OF)
Per IAS 16, Property, Plant and Equipment, depreciation should have commenced on this date/on 1 June 2018/one month. The depreciation charge for the year should therefore have been £1,740 (208,800 ÷ 10 x 1/12). The carrying amount of the warehouse at 30 June 2018 is therefore £207,060 (208,800 – 1,740).	½ 1 (OF) ½ (OF)
(4) Government grant	**(10½)**
Per IAS 20, Accounting for Government Grants, a grant should only be recognised when there is reasonable assurance that the entity: • will comply with any conditions attached to the grant, and • will actually receive the grant.	 ½ ½
Rigatoni Ltd has received the grant (on 1 March 2018) and has complied with the conditions (by employing 60% "local" employees).	½ + ½ ½ + ½
This is an income-related/revenue grant and should be recognised over the period in which the related expenditure is being incurred, so from 1 June 2018/when the employees were first employed. As Rigatoni Ltd expects to be able to meet the percentage condition for five years then the grant should also be recognised over the five years from this date.	½ ½ + ½ ½ ½
The grant should not be recognised in full on receipt.	½
Rigatoni Ltd's accounting policy is to recognise the grant as other income, however only one month of the five year grant should have been recognised this year ie £1,200 (72,000 x 1/12 ÷ 5). The remaining £70,800 (72,000 – 1,200) should be reversed from other income and recognised in deferred income. £14,400 (72,000 ÷ 5) will be shown in current liabilities and £56,400 (70,800 – 14,400) in non-current liabilities.	½ + ½ 1 (OF) ½ (OF) + ½ ½ ½ re split + ½ (OFs)
Total possible marks Maximum full marks	40½ 26

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2.2 Revised consolidated profit for the year

	£	Marks
Draft profit	145,800	
(1) Share of profit in joint venture	7,800	½ (OF)
(1) Unrealised profit on sale to joint venture	(500)	½ (OF)
(3) Interest capitalised	8,800	½ (OF)
(3) Depreciation charge	(1,740)	½ (OF)
(4) Reversal of grant income	(70,800)	½ (OF)
	89,360	

Total possible marks	2½
Maximum full marks	2

2.3 IFRS v UK GAAP differences

UK GAAP	IFRS	Marks
(3) Borrowing costs		
Under FRS 102 an entity can choose whether or not to capitalise borrowing costs.	IAS 23 gives no such choice. Capitalisation is required.	½ + ½
(4) Government grant		
FRS 102 only allows income-related grants to be recognised in income.	IAS 20 gives a choice for the treatment of income-related grants: as a credit in profit or loss (= deferred income), or a deduction from the related expense (= netting off).	½ ½ ½ ½ + ½
The income is recognised using either the performance model or the accrual model.		
Under the performance model if there are performance conditions then the grant is recognised when those conditions are met.	In either case the grant is recognised over the period in which the expenditure is incurred.	½ + ½
Under the accrual model the grant is recognised in income on systematic basis over the period the expenditure is incurred.		½

Tutorial notes

Since the shares in the joint venture were acquired on incorporation, any reference to implicit goodwill in (1) is not relevant.

Total possible marks	5
Maximum full marks	4

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Question 3

Total Marks: 15

General comments
This was a mixed topic question. Part 3.1 required the preparation of extracts from a single entity statement of cash flows. Part 3.2 required consideration of the different users of the financial statements and the type of decisions they make.

3.1 Linguine Ltd			**Marks**
Statement of cash flows for the year ended 30 June 2018 (extract)			Pres 1
	£	**£**	
Cash generated from operations (W1) ½ for 256,200 if no W1		614,900	½ (OF)
Cash flows from investing activities			
Purchase of property, plant and equipment	(214,600)		½ Ab
Net cash used in investing activities		(214,600)	
Cash flows from financing activities			
Proceeds from issue of ordinary share capital (625,000 (W3) + 175,000 (W4))	800,000		
Payment of finance lease liabilities	(14,000)		½ Ab
Dividends paid (W5)	(443,300)		
Net cash from financing activities		342,700	

Workings

(1) Cash generated from operations

	£	Marks
Draft cash generated from operations	256,200	½ Ab
Finance cost (15,000 – 14,000)	1,000	½ Ab
Depreciation charge	314,000	½ Ab
Profit on sale of property, plant and equipment	(12,700)	½ Ab
Adjustment to movement in trade and other receivables (43,700 (W2) + 12,700)	56,400	½ (OF) + ½ Ab
	614,900	

Minus ½ for wrong direction/category/not on face

(2) Property, plant and equipment

	£		£	Marks
B/d	987,200	P or L	314,000	
Cash	214,600	Disposals (β)	43,700	½
Revaluation surplus (W5)	125,300	C/d	969,400	½ + ½
	1,327,100		1,327,100	

(3) Share capital

	£		£	Marks
		B/d	1,500,000	
		Share premium (1,500,000 ÷ 4)	375,000	½ Ab
C/d	2,500,000	Cash (β)	625,000	½
	2,500,000		2,500,000	

(4) Share premium

	£		£	Marks
Share capital (W2)	375,000	B/d	600,000	½ (OF)
C/d	400,000	Cash (β)	175,000	½
	775,000		775,000	

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(5) Revaluation surplus

	£		£	
		B/d	150,300	½
C/d	275,600	PPE (β)	125,300	
	275,600		275,600	

(6) Retained earnings

	£		£	
Cash (β)	443,300	B/d	2,968,500	
C/d	3,560,800	P or L	1,035,600	½
	4,004,100		4,004,100	

Total possible marks	10
Maximum full marks	10

3.2 User groups and the decisions they need to make	Up to 1½ marks for five users
Present and potential investors Do not allow as two categories of users (per LMs and OBT) - Likely risk and return of investment/potential investment/ - Ability of entity to pay dividends - Whether to buy/sell shares	5 = 1½ 4 = 1 3 = ½ 2 = ½ 1 = 0
Employees - Employer's stability and profitability/job security - Ability of employer to provide remuneration/retirement and other benefits - Employment opportunities	
Lenders - Whether loans and interest can be repaid when due	½ mark each valid point to max of 1½ marks for any one user (over five users)
Suppliers and other trade payables - Likelihood of being paid when due/whether should offer credit	
Customers - Whether the entity will continue in existence	
Governments and trade agencies*/Regulators as alternative* - How to allocate central resources - How best to regulate activities - Taxation due - Basis for national statistics	
The public - Trends and recent developments in prosperity/activities - Likely impact on local economy	
Analysts/advisors - To assess past performance of the company and therefore likely future performance for both capital market and merger and acquisition purposes.	
Total possible marks	7½
Maximum full marks	5

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Question 4

Total Marks: 22

This question required the preparation of a consolidated statement of profit or loss, with two subsidiaries (one of which was acquired during the year). Adjustments included a provision for unrealised profit and a fair value adjustment on acquisition. An extract from the consolidated statement of changes in equity showing the retained earnings and non-controlling interest columns was also required.

Barbina plc — **Marks**

Consolidated statement of profit or loss for the year ended 30 June 2018

	£	Marks
		Pres 1
Revenue (W1)	1,475,600	
Cost of sales (W1)	(795,840)	
Gross profit	679,760	
Operating expenses (W1)	(377,820)	
Profit from operations (W1)	301,940	
Investment income (W1)	13,000	
Profit before tax	314,940	
Income tax expense (W1)	(79,400)	
Profit for the year	235,540	
Profit attributable to		
Owners of Barbina plc (β)	205,384	½ for split with OFs
Non-controlling interest (W2)	30,156	
	235,540	

Consolidated statement of changes in equity for the year ended 30 June 2018 (extract)

	Retained earnings £	Non-controlling interest £	Marks
			Pres 1
At 1 July 2017 (W6)/(W5)	1,287,080	194,220	1 (OFs)
Total comprehensive income for the year	205,384	30,156	1 (OFs)
Added on acquisition of subsidiary (W3)	-	178,584	½ (OF)
Dividends (500,000 x 20p) (400,000 x 30p x 30%)	(100,000)	(36,000)	1 Abs
At 30 June 2018 (W7)/(W8)	1,392,464	366,960	

Workings

(1) Consolidation schedule

	Barbina plc	Fusilli Ltd	8/12 Macaroni Ltd	Adj	Consol	Marks
						½ (8/12)
	£	£	£	£	£	1½ (P+Ss)
Revenue	789,600	501,200	200,800			
– Inter-co trading				(16,000)	1,475,600	½
Cost of sales – per Q	(401,200)	(302,800)	(105,440)			
– Inter-co trading				16,000		½ OF
– PURP (W4)	(1,600)					½ OF
– FV deprec (8,400 ÷ 7yrs *1,200 = ½* x 8/12 *½* *Column = ½*			(800)		(795,840)	1½
Op expenses – per Q	(201,100)	(111,200)	(65,520)		(377,820)	
Investment income	97,000				13,000	
– Fusilli (400,000 x 30p x 70%) *120,000 ½*				(84,000)		1
Tax	(56,000)	(17,400)	(6,000)		(79,400)	
		69,800	23,040			

(2) Non-controlling interest in year

	£	Marks
Fusilli Ltd (69,800 (W1) x 30%)	20,940	½ (OF)
Macaroni Ltd (23,040 (W1) x 40%)	9,216	½ (OF)
	30,156	

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(3) Non-controlling interest added on acquisition – Macaroni Ltd

	£	
Share capital	300,000	½ Ab
Retained earnings at 30 June 2018	161,900	½ Ab
Less: Profit 1 November 2017 – 30 June 2018 (35,760 x 8/12)	(23,840)	½ Ab
Fair value adjustment	8,400	½ Ab
	446,460	
x 40%	178,584	½ (OF)

(4) PURP

	%	£	
SP	100	16,000	
Cost	(80)	(12,800)	
GP	20	3,200	½ Ab
x ½		1,600	½ (OF)

(5) Non-controlling interest at 1 July 2017 – Fusilli Ltd

	£	£	
Fair value at acquisition		123,600	½ Ab
Share of post-acquisition reserves (524,800 – 69,800 + 120,000 – 325,600) *½ each*	249,400		2
	x 30%	74,820	½
Share of goodwill impairment (14,000 x 30%)		(4,200)	½ Ab
		194,220	

(6) Retained earnings at 1 July 2017

	£	
Barbina plc (1,250,600 – 228,300 + 100,000) *½ each*	1,122,300	1½
Fusilli Ltd: Share of post-acquisition reserves (249,400 (W5) x 70%)	174,580	½ (OF)
Share of impairment (14,000 x 70%)	(9,800)	½ Ab
	1,287,080	

(7) Non-controlling interest at 30 June 2018 (for proof only)

Fusilli Ltd: At acquisition	123,600		½
Share of post-acq profits ((524,800 – 325,600) x 30%)	59,760		½
Share of goodwill impairment (14,000 x 30%)	(4,200)		½
		179,160	
Macaroni Ltd: Share capital	300,000		½
Retained earnings	161,900		½
Fair value adjustment	8,400		½
Depreciation thereon	(800)		½
	469,500		
	x 40%	187,800	½
		366,960	

(8) Retained earnings at 30 June 2018 (for proof only)

Barbina plc	1,250,600	
Fusilli Ltd: Share of post-acq profits ((524,800 – 325,600) x 70%)	139,440	½
Share of impairment (14,000 x 70%)	(9,800)	½
Macaroni Ltd: Share of post-acq profits (23,040 (W1) x 60%)	13,824	½
PURP (W4)	(1,600)	½
	1,392,464	

Total possible marks	22½
Maximum full marks	22

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