Answers

1 (a) Explanatory note to: Directors of Carbise
Subject: Foreign subsidiary Bikelite

(i) The presentation currency is the currency in which the financial statements are presented. IAS® 21 *The Effects of Changes in Foreign Exchange Rates* permits an entity to present its individual financial statements in any currency. It would therefore be up to the directors of Bikelite to choose a presentation currency for its individual financial statements. Factors which could be considered include the currency used by major shareholders and the currency in which debt finance is primarily raised.

The functional currency is the currency of the primary economic environment in which the entity operates. Since transactions are initially recorded in an entity's functional currency, the results and financial position would need to be retranslated where this differed to the presentation currency.

When determining the presentation and functional currency of Bikelite, consideration should first be given to whether the functional currency of Bikelite should be the same as Carbise, at least whilst under the control of Carbise. It appears that Bikelite has considerable autonomy over its activities. Despite being acquired to make more efficient use of the surplus inventory of Carbise, purchases from Carbise were only 5% of Bikelite's total purchases. Revenue is invoiced in a range of currencies suggesting a geographically diverse range of customers which, although this allows Carbise access to new international markets, is unlikely to be classified as an extension of the parent's operations. The volume of the transactions involved between Carbise and Bikelite would seem to be far too low to come to this conclusion. Bikelite also appears free to retain cash in a range of currencies and is not obliged to remit the cash to Carbise in the form of dividends. Nor does Bikelite appear to be dependent on financing from Carbise with other investors taking up the bond issue at the start of 20X6. The functional currency of Bikelite does not need to be the same as Carbise.

In choosing its functional currency, Bikelite should consider the following primary factors: the currency which mainly influences the sales price for their goods, the currency of the country whose competitive forces and regulations determine the sales price and also the currency which influences labour, material and overhead costs. The key determinant here is the currency which the majority of the transactions are settled in. Bikelite invoices and is invoiced in a large range of currencies and so it would not be immediately clear as to the appropriate functional currency. Nor is there detail about whether there is a currency in which competitive forces and regulations could be important. We do not know, for example, what currency Bikelite's major competitors invoice in.

Secondary factors including the currency in which financing activities are obtained and the currency in which receipts from operating activities are retained can help guide the entity where it is not immediately clear. In relation to Bikelite, a significant volume of their sales are invoiced in dinars and the majority of their expenses too, given that wages and overheads are also paid in dinars. Funds were raised in dinars from the bond issue and so it would appear that the dinar should probably be the functional currency for Bikelite. It is also possible that Bikelite may lose their autonomy on Carbise's sale of their shares which could have implications for the determination of the functional currency.

(ii) Goodwill in dinars on the acquisition of Bikelite would be dinar 42 million calculated as follows:

	Dinars millions
Consideration	100
FV of NCI	22
Less net assets at acquisition (60 + 20)	(80)
Goodwill at acquisition	42

On acquisition, the goodwill in \$ would be (dinar 42m/0·5) \$84 million.

Goodwill at 30 September 20X6 would be:

	Dinar millions	rate	\$ millions
Goodwill at 1 January 20X2	42	0·5	84
Impairment y/e 31 December 20X5	(6)	0·4	(15)
Exchange gain			25·7 (bal)
Goodwill at 31 December 20X5	36	0·38	94·7
Current year exchange gain			8·2 (bal)
Goodwill at 30 September 20X6	36	0·35	102·9

Workings

Dinar impairment of 6 million is translated at the average rate of \$1:0·4 dinar = \$15 million.

Goodwill at 31 December 20X5 would be translated at last year's closing rate of \$1:0·38 dinar = \$94·7m.

Goodwill at 31 September 20X6 will be translated at \$1:0·35 dinar = \$102·9m.

(iii) On a business combination, goodwill is calculated by comparing the fair value of the consideration plus non-controlling interests (NCI) at acquisition with the fair value of the identifiable net assets at acquisition. Carbise measures NCI using the fair value method. This means that goodwill attributable to the NCI is included within the overall calculation of goodwill. An adjustment of dinar 20 million is required to the property of Bikelite to ensure the net assets at acquisition are properly included at their fair value.

At each year end, all assets (and liabilities) are retranslated using the closing rate of exchange. Exchange differences arising on the retranslation are recorded within equity. Since the non-controlling interest is measured under the fair value method, the exchange difference would be apportioned 80%/20% between the owners of Carbise and the non-controlling interest. Only the current year's exchange difference would initially be recorded within other comprehensive income for the year ended 31 December 20X6 whereas cumulative exchange differences on goodwill at 30 September 20X6 would be recorded within equity.

(b) The net assets of Bikelite would have been retranslated each year at the closing rate of exchange. There is therefore an exchange difference arising each year by comparing the opening net assets at the opening rate of exchange with the opening net assets at the closing rate of exchange. An additional exchange difference arises through the profit or loss of Bikelite each year being translated at the average rate of exchange in the consolidated statement of comprehensive income. The profit or loss will increase or decrease the net assets of Bikelite respectively which, as is indicated above, will be translated at the closing rate of exchange within the consolidated statement of financial position. As with goodwill, the exchange differences are included within equity with 80% attributable to the shareholders of Carbise and 20% to the NCI. Cumulative exchange differences will be included within the consolidated statement of financial position with just current year differences recorded within other comprehensive income.

The carrying amount of the net assets of Bikelite on 1 January 20X6 was dinar 48 million. The fair value of their opening net assets therefore would be dinar 64 million (dinar 48 + 16/20 x dinar 20 million). Bikelite would only be consolidated for the first nine months of the year since Carbise loses control on 30 September 20X6. Losses per the individual accounts for the year ended 31 December 20X6 were dinar 8 million, so only dinar 6 million would be consolidated. Additional depreciation of dinar 0·75 million (dinar 20m/20 x 9/12) would be charged for the first nine months of the year. Net assets at disposal in dinars would therefore be dinar 57·25 million (dinar 64 – dinar 6·75). The exchange difference arising in the statement of comprehensive income for the year ended 31 December 20X6 would be $13·4 million calculated as follows:

	$ millions
Opening net assets at opening rate (dinar 64/0·38)	168·4
Loss for 9 months at average rate (dinar 6·75/0·37)	(18·2)
Current year exchange gain (balance)	13·4
Net assets at 30 September 20X6 (dinar 57·25/0·35)	163·6

$10·7 million of the exchange differences are attributed to the shareholders of Carbide (80% x $13·4) and $2·7 million to the NCI.

(c) (i) Group profit or loss on disposal on Bikelite

	$ millions
Proceeds	150
Net assets at disposal (see (b))	(163·6)
Goodwill at disposal (see (a)(ii))	(102·9)
NCI at disposal	48·5
Exchange gains recycled to profit and loss	76·6
Group profit on disposal	8·6

Workings

Exchange gains at 1 January 20X6 per question are $74·1 million. Current year exchange differences on goodwill are $8·2 million (see (b)(i)) and on the net assets are $13·4 million (see (b)). Cumulative exchange gains at 30 September 20X6 are therefore $95·7 million. On disposal, the parent's share (80%) = $76·6 million should be recycled to profit or loss.

NCI at disposal is calculated as follows:

	$ millions
NCI at 1 January 20X6 per question	47·8
NCI share of loss to 30 September 20X6 (20% x dinar 6·75m (see (b))/0·37)	(3·6)
NCI share exchange gains for 9 months to 30 September 20X6 (20% x (13·4 + 8·2))	4·3
NCI at 30 September 20X6	48·5

(ii) For the year ended 31 December 20X6, Carbise will consolidate Bikelite for the first nine months of the year up to the date of disposal of the shares and subsequent loss of control. NCI will be calculated on the first nine months of losses. Exchange differences on the translation of the net assets, profits and goodwill in relation to the nine months to 30 September 20X6 will initially be recognised in other comprehensive income classified as gains which will be reclassified subsequently to profit or loss.

On 30 September 20X6, a consolidated profit or loss on disposal will be calculated in the consolidated financial statements of Carbise. In effect, the proceeds are compared to the net assets and unimpaired goodwill not attributable to the non-controlling interest at the disposal date. The cumulative exchange differences on the translation of Bikelite would be reclassified to profit or loss.

Consideration should be given as to whether the disposal of Bikelite would constitute a discontinued operation. For Bikelite to be classified as a discontinued operation, it would need to represent a separate major line of business or geographical area of operations. Since Bikelite was initially acquired by Carbise to gain easier access to international markets, it is likely that the criterion would be met.

2 **(a)** The remeasurement component is taken to other comprehensive income and comprises:

- Actuarial gains and losses, such as the return on plan assets which differs from the expected return on the assets included within the net interest figure;
- Changes in the asset ceiling not included within the net interest calculation.

Actuarial gains and losses are sometimes referred to as experience adjustments and arise due to differences between actuarial assumptions and what actually occurred during the period. These will arise in instances such as unexpected movements on interest rates, unexpectedly high or low rates of employee turnover or unexpected increases or decreases in wage growth. The redundancies will create an unusually high level of staff turnover but this should not be treated as part of the remeasurement component. The redundancy will cause the present value of the obligations arising from the defined benefit to decrease. This is classified as a curtailment rather than an experience adjustment to be included within other comprehensive income.

A distinction needs to be made between the basic settlement and the additional pension contribution. The basic settlement is an obligation which Hudson has to pay as compensation for terminating the employee's services regardless of when the employee leaves the entity. IAS 19 *Employee Benefits* requires such payments to be recognised at the earlier of when the plan of termination is announced and when the entity recognises the associated restructuring costs associated with the closure of Wye.

Hudson should therefore have provided in full for the cost of the basic settlement regardless of whether the staff have left or not. This should be recognised as part of the past service cost in the profit or loss of Hudson for the year ended 31 December 20X2.

The additional pension contribution is only paid to employees who complete service up to the closure of division Wye. Since this is expected in early 20X3, these should be accounted for as a short-term benefit. In effect, the contributions are in exchange for the period of service until redundancy. Hudson should estimate the number of employees who will remain with Hudson until the closure of Wye. The cost of this payment should then be spread over the period of service. Since this should be included within the current service cost, this will have an adverse effect on the profit or loss in both 20X2 and 20X3.

In line with the criteria to recognise any provision, as set out in IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, an 'obligating event' must have arisen for a restructuring provision and for the associated restructuring costs to be recognised. Furthermore, specific conditions must exist for such an obligating event to have arisen in relation to a restructuring provision:

- a detailed formal plan for the restructuring is in place identifying certain criteria required by the accounting standard; and
- a valid expectation has been created in those affected that the restructuring will be carried out, either by starting to implement the plan or publicly announcing its main features.

In the case of Hudson, a valid expectation has been created because the restructuring has been announced, the redundancies have been confirmed and the directors have approved the restructuring in a formal directors meeting. IAS 37 specifically sets out that a provision cannot be made where only a management or board decision to restructure has been taken as it is not considered that this in itself gives rise to an obligation to restructure. IAS 37 also specifies that only the direct expenditure which is necessary as a result of restructuring can be included in the restructuring provision. This includes costs of making employees redundant and costs of terminating certain leases and other contracts directly as a result of restructuring. However, it specifically excludes costs of retraining or relocating staff, marketing or investment in new systems and distribution networks, as these costs relate to future operations and so do not fall under the definition of a provision. Thus the costs of ongoing activities such as relocation activities cannot be provided for.

(b) Deferred taxes represent the amounts of income taxes payable or recoverable in future periods in respect of temporary differences. Temporary differences are differences between the carrying amount of an asset or liability and its tax base. A deferred tax asset arises where the tax base of an asset exceeds the carrying amount. A deferred tax asset can also occur when the tax base of a liability differs from its carrying amount; the eventual settlement of the liability represents a future tax deduction. In relation to unused trading losses, the carrying amount is zero since the losses have not yet been recognised in the financial statements of Hudson. A potential deferred tax asset does arise but the determination of the tax base is more problematic.

The tax base of an asset is the amount which will be deductible against taxable economic benefits from recovering the carrying amount of the asset. Where recovery of an asset will have no tax consequences, the tax base is equal to the carrying amount.

Hudson operates under a tax jurisdiction which only allows losses to be carried forward for two years. The maximum the tax base could be is therefore equal to the amount of unused losses for 20X1 and 20X2 since these only are available to be deducted from future profits. The tax base though needs to be restricted to the extent that there is a probability of sufficient future profits to offset the trading losses.

The directors of Hudson should base their forecast of the future profitability on reasonable and supportable assumptions. There appears to be evidence that this is not the case. Hudson has a recent history of trading losses and there is little evidence that there will be an improvement in trading results within the next couple of years. The market is depressed and sales orders for the first quarter of 20X3 are below levels in any of the previous five years. It is also likely that Hudson will incur various costs in relation to the restructuring which would increase losses into 20X3 and possibly 20X4. Only directly attributable expenses such as redundancies should be included within a provision and expensed in 20X2 which would increase the current year loss. On-going expenses may be incurred such as retraining and relocating costs but these should only be expensed from 20X3. The forecast profitability for 20X3 and subsequent growth rate therefore appear to be unrealistically optimistic. Given that losses can only be carried forward for a maximum of two years, it is unlikely that any deferred tax asset should be recognised.

(c) The directors of Hudson are paid a bonus based upon earnings before interest, tax depreciation and amortisation (EBITDA). It is possible therefore, despite the losses, that once these items are adjusted for the directors may receive a bonus. A self-interest threat will arise. The directors have an incentive to manipulate the financial statements in order to try to minimise the losses and maximise profits. Directors have an ethical responsibility to produce financial statements which are fair, objective and a transparent record of the entity's affairs.

There is evidence that the directors are willing to manipulate the financial statements in a way directly contrary to the ethical principles of integrity and objectivity. It is likely that a net expense should be recognised for the termination payments on the assumption that they would exceed the reduction in present value of the obligation from the curtailment. The directors are wishing to recognise this within other comprehensive income rather than profit or loss despite knowing that it is contrary to international accounting standards. This would improve profitability although it would not impact upon net assets due to a corresponding decrease in equity. The directors also have not recognised a restructuring provision despite the terms being communicated to staff. It is possible that this would be treated as an exceptional cost and therefore would not impact on the bonus. It would therefore be useful to examine the precise terms of the contracts in order to assess the potential impact on the bonus. The treatment does, however, at least in the short term, help Hudson to improve their net assets position.

The deferred tax asset is based upon forecasts for too long a period and is also based on unrealistic assumptions. Earnings before interest, tax, depreciation and amortisation will be overstated as a direct consequence. Net assets will also be overstated, helping Hudson to meet its debt covenant obligations.

The directors' explanation for their proposed treatments are not justified. Directors are appointed to run the business on behalf of the company's shareholders who are the primary stakeholder. It will be in the shareholders' interests for the company to be profitable and to maintain net assets within the debt covenant stipulations. However, this should not be at the expense of the credibility and transparency of the financial statements. Deliberate manipulation of financial statements will reduce stakeholders' confidence in the reliability of the financial statements and the accountancy profession as a whole. The directors are deliberating flouting International Financial Reporting Standards (IFRS® Standards) to improve their bonus and maintain debt covenant obligations.

The directors' actions with regard to the accountant are contrary to the ethical principles of professional behaviour. It appears that the directors have put the accountant under undue pressure to falsify the financial statements to meet their own needs. An intimidation threat arises from the directors' implying that the accountant would lose their job should they not comply with the directors' instructions.

The accountant would also be bound by the ACCA *Code of Ethics* and must adhere to the same ethical principles. They must not therefore comply with the directors' instructions. The accountant should remind the directors of their obligations to comply with the *Code of Ethics*. Should the accountant feel unable to approach the directors directly, they could consider talking to those charged with governance and, in particular, non-executive directors to explain the situation. The accountant could also seek help from the ACCA ethical helpline and take legal advice. Ultimately, if the situation cannot be resolved, the accountant could consider resigning and seeking employment elsewhere.

3 (a) (i) Before assessing whether an entity has joint control over an arrangement, an entity must first assess whether the parties control the arrangement in accordance with the definition of control in IFRS 10 *Consolidated Financial Statements*. If not, an entity must determine whether it has joint control of the arrangement. IFRS 11 *Joint Arrangements* defines joint control as 'the contractually agreed sharing of control of an arrangement, which exists only when decisions about the relevant activities require the unanimous consent of the parties sharing control'. This means an assessment as to whether any party can prevent any of the other parties from making unilateral decisions without its consent. It must be clear which combination of parties is required to agree unanimously to decisions about the relevant activities of the arrangement. In the case of Kurran, there is more than one combination of parties possible to reach the required majority. As a result, Crypto does not have joint control.

In addition to the above, Crypto does not control Kurran because IFRS 10 states that control requires power over the investee which gives the investor the ability to direct the relevant activities. Crypto does not have the ability to direct the relevant activities as it can only block decisions, and cannot make decisions by itself. Also, there is no shareholder agreement which sets out shareholders' voting rights and obligations and thus the other shareholders can act together to prevent Crypto from making decisions in its own interest. Crypto does not have joint control as agreement between itself and other board members has to occur for a decision to be made. Therefore, it appears that Kurran is an associate of Crypto and would apply IAS 28 *Investments in Associates and Joint Ventures*.

(ii) IFRS 9 *Financial Instruments* states that 'any embedded derivative included in a contract for the sale or purchase of a non-financial item that is denominated in a foreign currency shall be separated when its economic characteristics and risks are not closely related to those of the host contract'. Thus, in contrast to the treatment for hybrid contracts with financial asset hosts, derivatives embedded with a financial liability will often be separately accounted for. That is, they must be separated if they are not closely related to the host contract, they meet the definition of a derivative, and the hybrid contract is not measured at fair value through profit or loss (FVTPL).

The contract is a hybrid contract containing a host contract which is an executory contract to purchase electricity at a price of 20 million euros and a non-closely related embedded foreign currency derivative with an initial fair value of zero to buy 20 million euros, sell 25 million dollars. However, the derivative should have been valued at FVTPL and not fair value through other comprehensive income.

At the date of the modification of the contract to the functional currency of Crypto, there is a significant change to the contract which will trigger a reassessment of its position under IFRS 9. As the contract no longer has a non-closely related embedded derivative, the entire arrangement will be accounted for prospectively as an executory contract which is outside the scope of IFRS 9. The embedded derivative will be derecognised and it is likely that Crypto will have to pay the counterparty 2 million euros in compensation.

(b) (i) IFRS 16 *Leases* introduces a single lessee accounting model and should reduce the number of off-balance sheet leases. Upon lease commencement, a lessee recognises a right-of-use asset and a lease liability. After lease commencement, a lessee measures the right-of-use asset using a cost model less accumulated depreciation and accumulated impairment. The lease liability is initially measured at the present value of the lease payments payable over the lease term, discounted at the rate implicit in the lease if that can be readily determined. Lease liabilities include only economically unavoidable payments.

Investors should bear in mind that some sectors and some companies will be more affected than others. As a result, companies with previous material off-balance sheet leases will report higher assets and financial liabilities. The standard will reduce complexity in financial statements as it should allow comparisons to be made between those companies who lease assets and those who borrow to buy assets.

Investors will no longer have to estimate the assets and liabilities resulting from off-balance sheet leases when calculating ratios as there should be fewer off-balance sheet leases. IFRS 16 will result in more information about leases both on the statement of financial position and in the notes and will provide a more accurate reflection of the economics of leases. The carrying amount of lease assets will typically reduce more quickly than the carrying amount of lease liabilities. This will result in a reduction in reported equity for companies with previous material off-balance sheet leases.

IFRS 16 requires a lessee to disclose lease liabilities separately from other liabilities as a separate line item, or together with other similar liabilities, in a manner which is relevant to understanding the lessee's financial position. A lessee will also split lease liabilities into current and non-current portions, based on the timing of payments.

(ii) The recognition of an asset which was previously unrecognised will result in a higher asset base, which will affect ratios such as asset turnover. The recognition of a liability which was previously unrecognised will result in higher financial liabilities, which will affect gearing. The recognition of depreciation and interest instead of operating lease expense will result in higher operating profit because interest is typically excluded from operating expenses and will affect performance ratios. Similarly, profit measures which exclude interest and depreciation but previously included operating lease expense, such as EBITDA, will be higher under IFRS 16.

Interest cover: there will be an increase in the earnings measure (i.e. EBITDA) which will not be proportionate to the increase in interest. The change in the ratio will depend on the characteristics of the lease portfolio.

Return on capital employed: it is likely that ROCE will be lower under IFRS 16 because the increase in operating profit is unlikely to be proportionate to the increase in capital employed.

Debt to EBITDA: ratio of debt to EBITDA is likely to be higher because debt will increase by more than the increase in earnings. Debt will increase because of the fact that lease liabilities will be recognised on the statement of financial position. For companies which have material off-balance sheet leases, IFRS 16 is expected to result in higher profit before interest because a company presents the implicit interest in lease payments for former off-balance sheet leases as part of finance costs. Previously, the entire expense related to off-balance sheet leases was included as part of operating expenses. The size of the increase in operating profit, and finance costs, will depend on the significance of leasing activities to the company.

4 (a) (i) The Exposure Draft (ED) proposes to define recognition as the process of capturing an item which meets the definition of an element. This approach requires recognition decisions to be made by reference to the qualitative characteristics of useful financial information.

The existing *Conceptual Framework* specifies three recognition criteria which apply for the recognition of all assets and liabilities:

(a) the item meets the definition of an asset or a liability;
(b) it is probable that any future economic benefit associated with the asset or liability will flow to or from the entity; and
(c) the asset or liability has a cost or value which can be measured reliably.

Existing IFRS Standards do not consistently apply the above criteria and thus the ED proposes that the elements of financial statements should be recognised if it provides users of financial statements with:

(a) relevant information about the asset or the liability and about any income, expenses or changes in equity;
(b) a faithful representation of the asset or the liability and of any income, expenses or changes in equity; and
(c) information which results in the benefits exceeding the cost of providing that information.

Recognition may not provide relevant information where it is uncertain whether an asset exists, or is separable from goodwill, or whether a liability exists and where there is only a low probability that an inflow or outflow of economic benefits will occur. Additionally, if the level of measurement uncertainty is so high that the resulting information has little relevance, then recognition should not occur. The International Accounting Standards Board feel the revised *Conceptual Framework* should not contain a 'probability criterion', which means that there may be recognition of assets or liabilities with a low probability of an inflow or outflow of economic benefit.

It is thought that the revised *Conceptual Framework* should identify only two criteria for recognition, that is relevance and faithful representation with the cost benefit criteria being removed as a third distinct recognition criterion. The latter would be mentioned as a general statement in the revised *Conceptual Framework* to explain that cost constrains recognition decisions and the recognition of an element must be sufficient to justify the costs of providing that information.

(ii) According to IAS 12 *Income Taxes*, deferred tax liabilities are recognised for all taxable temporary differences, with three exceptions. However, deferred tax assets are only recognised to the extent that it is probable that taxable profit will be available against which the deductible temporary differences can be utilised. Thus the standard only applies the probability threshold to deferred tax assets and not to liabilities. The accounting for deferred tax seems to be based upon the matching principle of income and tax expenses rather than the definitions of an asset and a liability, with the result that the model results in deferred debits which are unlikely to result in tax cash outflows and thus do not meet the criterion of an expected future outflow of economic benefits in the *Conceptual Framework*.

Although the *Conceptual Framework* gives the same threshold for recognition of assets and liabilities, IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* requires the recognition of assets when they are virtually certain but for liabilities when they are probable, defined as more likely than not. IAS 37 also requires the recognition of liabilities for constructive obligations. Thus, the definition of an obligation under IAS 37 can often be broader than in other standards, for example, IAS 32 *Financial Instruments: Presentation*.

IAS 37 includes a probable outflow threshold for the recognition of provisions but the recognition threshold does not apply to obligations which normally fall within the scope of IAS 37 when they are acquired as part of a business combination. IFRS 3 *Business Combinations* requires recognition of the contingent liabilities of a subsidiary irrespective of their probability. IFRS 10 *Consolidated Financial Statements* requires recognition at fair value of contingent consideration to be received for a business which is disposed of, even if the inflow is not probable. Thus, these items are recognised under IFRS 3/IFRS 10 when they arise from a business combination, whereas they are not recognised in the normal course of business.

(b) (i) IFRS 15 *Revenue from Contracts with Customers* states that an entity must first identify the contract with the customer and as part of that identification, the entity has to determine whether it is probable that the consideration which the entity is entitled to in exchange for the goods or services will be collected. An assessment of collectability is included as one of the criteria for determining whether a contract with a customer exists.

IFRS 15 states that the entity must identify the performance obligations in the contract. Once an entity has identified the contract with a customer, it evaluates the contractual terms and its customary business practices to identify all the promised goods or services within the contract and determine which of those promised goods or services will be treated as separate performance obligations. An entity will have to decide whether the obligations are distinct or part of a series of distinct goods and services which are substantially the same and have the same pattern of transfer to the customer. A good or service is distinct if the customer can benefit from the good or service on its own.

(ii) Technology entities often enter into transactions involving the delivery of multiple goods and services.

As regards Oinventory, it seems that all of the individual goods and services in the contract are distinct because the entity regularly sells each element of the contract separately and is not providing the significant service of integrating the goods and services. Also, as the customer could purchase each good and service without significantly affecting the other goods and services purchased, there is no dependence upon individual elements of the service. Thus hardware, professional services and hosting services should each be accounted for as separate performance obligations.

Regarding InventoryX, the professional services are distinct because Zedtech frequently sells those services on a stand-alone basis.

However, the hardware is always sold in a combined contract with the professional and hosting services and the customer cannot use the hardware on its own. As a result, the hardware is not distinct and because the hardware is integral to the delivery of the hosted software, the hardware and hosting services should be accounted for as one performance obligation while the professional services, which are distinct, would be a separate performance obligation.

When performing the collectability assessment, Zedtech only considers the customer's ability and intention to pay the expected consideration when due. Zedtech has entered into an arrangement and does not expect to collect the full contractual amount such that the contract contains an implied price concession. Therefore, Zedtech needs to assess the collectability of the amount to which it expects to be entitled, rather than the stated contractual amount. Zedtech assesses whether collectability is probable, whether the customer has the ability and intent to pay the estimated transaction price. Zedtech will determine that the amount to which it expects to be entitled is \$2·4 million and performs the collectability assessment based on that amount, rather than the contractual price of \$3 million.

				Marks	*Marks*
1	**(a)**	**(i)**	– discussion of presentation and functional currency		
			– application of the above discussion to the scenario	2	
				5	7
		(ii)	– calculation of goodwill	2	
			– calculation of the exchange difference on goodwill	3	5
		(iii)	– explanation of the goodwill calculation and application to the scenario	2	
			– explanation of the exchange gain and application to the scenario	2	4
	(b)		– explanation of Bikelite exchange differences	3	
			– calculation of Bikelite exchange differences for y/e 20X6:		
			translation	3	
			split between parent and NCI	1	7
	(c)	**(i)**	– calculation of group profit or loss on disposal		3
		(ii)	– explanation of the accounting treatment of Bikelite		4
					30
2	**(a)**		– application of the following discussion to the scenario:		
			what should be included in the remeasurement component	2	
			correct treatment of the basic component	2	
			correct treatment of the additional pension contribution	2	
			– discussion of restructuring costs	2	8
	(b)		– an explanation of temporary differences and asset tax base	3	
			– application of above discussion to the scenario	2	5
	(c)		– application of the following discussion of accounting issues to the scenario:		
			termination payments	2	
			tax losses	1	
			– consideration of the ethical implications and their resolution	2	5
			Professional marks		2
					20
3	**(a)**	**(i)**	– discussion of the following accounting issues and application to the scenario:		
			the definition of control per IFRS 10 and joint control per IFRS 11	3	
			power over the investee	3	6
		(ii)	– discussion of the following accounting issues and application to the scenario:		
			IFRS 9 requirements for embedded derivatives and hybrid	3	
			IFRS 9 requirements for contract modifications	2	5
	(b)	**(i)**	– a discussion of the IFRS 16 requirements	3	
			– implications for investors	3	6
		(ii)	– a description of the IFRS 16 impact on accounting numbers	2	
			– impact on the following ratios:		
			Interest cover	2	
			ROCE	1	
			Debt to EBITDA	1	6
			Professional marks		2
					25

				Marks	Marks
4	(a)	(i)	– discussion of recognition per current *Conceptual Framework*	2	
			– discussion of the ED's approach to recognition	2	
			– comparison and contrast	3	7
		(ii)	– discussion of IAS 12 recognition criteria	2	
			– discussion of IAS 37 recognition criteria	2	
			– discussion of recognition in business combinations	2	6
	(b)	(i)	– discussion of the collectability of consideration	2	
			– discussion of performance obligations	3	5
		(ii)	– application of the above principles to:		
			Oinventory	2	
			InventoryX	3	
			– collectability assessment	2	7
					25

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