Content

Introduction

There are different study materials and modes for you to prepare for ACCA professional exams.

You can prepare the exam through self-study mode by reading textbooks and practicing revision tests from Approved Content Providers

Or you can go directly to the classes offered by ACCA Approved Learning Partners and stick into their notes.

However, no matter you are choosing which modes of study or which textbook, you need to know the technical articles published by ACCA for each paper is one of the best materials to prepare for your exams that you cannot miss.

In general, the articles are published by ACCA exam team and the contents are updated on a regular basis.

They highlight the core concepts or important areas that a lot of students cannot do well in the past exams.

The most important part is technical articles are generally the guidance to which question to be seen in upcoming exam.

Here are June 2018 examiners comments on ACCA Paper P7 (Advanced Audit & Assurance):

Question Five

This was a reporting question and was in two sections. It was noted that this question was favoured by candidates who had obviously read the recently updated relevant article on the student website.

The second requirement was to critically appraise an extract from an auditor's report, which had been incorrectly prepared and needed amendment. As noted above it was clear that the candidates who selected this question had evidently read the relevant article and were able to identify that the sections were in the wrong order, contained inappropriate wording and that the key audit matters and emphasis of matters paragraphs had been incorrectly used. Good candidates were able to explain when an issue should be included as a key audit matter or if the issue would result in a qualification and hence needed to be part of the basis of opinion paragraph. Other candidates correctly commented that it would be inappropriate to include an emphasis of matter paragraph but that the report should include a section headed material uncertainty related to going concern.

Since it help thousands of students to prepare exam, I organized the articles published by ACCA and summarized them according to their topics and syllabus with relevant questions as Supplementary Notes for those who are interested to focus on the key or challenging areas.

Remember these articles are helping you to enhance your knowledge on particular subjects, and not a substitute of approved textbook.

Chapter 1 Trade Receivables and Revenue

Executive Summary

The total value of trade receivables for a business at any one time represents the amount of sales which have not yet been paid for by customers

The key principle of IFRS 15 is that revenue is recognised to depict the transfer of promised goods or services to customers at an amount that the entity expects to be entitled to in exchange for those goods or services.

Key Topics for financial accounting:

1. Recording the credit sale
2. Encouraging prompt payment/settlement
3. Customer fails to pay
4. Making an allowance for receivables
5. Credit control:
    a. Who gets credit?
    b. Terms of credit
    c. Administration of billing and collection

Trade receivables arise when a business makes sales or provides a service on credit. For example, if Ben sells goods on credit to Candar, Candar will take delivery of the goods and receive an invoice from Ben. This will state how much must be paid for the goods and the deadline for payment – for example, within 30 days. Ben now has a trade receivable – the amount payable to him by Candar.

The total value of trade receivables for a business at any one time represents the amount of sales which have not yet been paid for by customers. The trade receivables figure will depend on the following:

1. The value of credit sales. The greater the value of credit sales then, other things being equal, the greater the total of trade receivables.
2. The period of credit given. The longer the period of credit given to customers then, other things being equal, the greater the total of trade receivables.
3. The efficiency with which the business administers its trade receivables. The more inefficient the business is in billing its customers and collecting overdue accounts then, other things being equal, the greater the total of trade receivables.

RECORDING THE CREDIT SALE

Let's imagine that Manfredi ordered materials from Ingrid on 16 March 20X0. The confirmation of the order states that the amount owing, $6,450, should be paid within 30 days from the date of the invoice. The sale was made on 17 March 20X0 and the goods have been delivered on that date. Manfredi inspected the materials and signed a delivery note and accepted the invoice for $6,450.

The invoice will be processed through Ingrid's accounting system. The original entry will be in Ingrid's Sales Day Book which lists all credit sales chronologically. Total credit sales (including the $6,450) will be posted from the Sales Day Book to the debit of trade receivables account and the credit of sales account – both accounts being in the General Ledger. The $6,450 will also be posted to the debit of a personal account opened for Manfredi and kept in the Receivables Ledger.

In a computerised accounting system, all these accounting entries and the production of the invoice would take place simultaneously.

Manfredi's account will look something like **Table 1** below in the Receivables Ledger.

Table 1: Manfredi's account in the receivables ledger

Manfredi

20X0		$	20X0		$
17 Mar	Sales	6,450			

Manfredi's account shows a debit balance. This is an asset because it 'is a resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity' (IASB Conceptual Framework for Financial Reporting, paragraph 4.4(a)).

Here the 'entity' is Ingrid's business, the 'past event' is the sale, and the 'future economic benefits' are represented by the cash received from Manfredi when he settles the invoice.

The debit balance is also a current asset because it meets the criteria in paragraph 66 of IAS 1, *Presentation of Financial Statements*. This states that an entity should classify an asset as current when any one of the following applies:

- (a) The entity expects to realise the asset, or intends to sell or consume it, in its normal operating cycle.
- (b) The entity holds the asset primarily for the purpose of trading.
- (c) The entity expects to realise the asset within 12 months after the reporting period.
- (d) The asset is cash or a cash equivalent (as defined in IAS 7) unless the asset is restricted from being exchanged or used to settle a liability for at least 12 months after the reporting period.

In this example, the asset meets criterion (c) because the amount is due within 30 days, and also criterion (a) because Ingrid's normal operating cycle is buying and selling on credit, collecting cash from customers, and paying suppliers.

The effect on the accounting equation is that inventory will decrease by the cost of the goods sold and receivables will increase by the selling price of the goods sold. So total assets increase by the profit made on the sale. This also increases capital/equity. There is no change in liabilities.

The profit on this transaction is therefore taken when the goods are sold even though no money has exchanged hands yet. This is because this transaction meets all of the requirements of IFRS 15:

The key principle of IFRS 15 is that revenue is recognised to depict the transfer of promised goods or services to customers at an amount that the entity expects to be entitled to in exchange for those goods or services.

This is achieved by applying a five step model:

1. Identify the contract(s) with a customer
2. Identify the performance obligations in the contract
3. Determine the transaction price
4. Allocate the transaction price to the performance obligations in the contract
5. Recognise revenue when (or as) the entity satisfies a performance obligation

Applying the five step model you can see all the criteria have been met:

1. Identify the contract(s) with a customer: Manfredi placed an order that was confirmed by Ingrid . This represents a contract to supply the materials.
2. Identify the performance obligations in the contract: There is one performance obligation, the delivery of the materials as ordered.
3. Determine the transaction price: This is the price agreed as per the order, ie $6,450. Note that sales tax is not included since transaction price as defined by IFRS 15 does not include amounts collected on behalf of third parties.
4. Allocate the transaction price to the performance obligations in the contract: There is one performance obligation, therefore the full transaction price is allocated to the performance of the obligation on the delivery of the materials on 17 March 20X0.
5. Recognise revenue when (or as) the entity satisfies a performance obligation: Since Manfredi has signed a delivery note to confirm acceptance of the materials as satisfactory, this is evidence that Ingrid has fulfilled its performance obligation and can therefore recognise $6,450 on 17 March 20X0.

Note. The timing of payment by Manfredi is irrelevant to when the revenue is recognised.

What happens now? If all goes well, Manfredi will keep to the terms of the agreement and Ingrid will receive payment within 30 days. If Manfredi pays on 16 April 20X0, Ingrid will debit this in her Cash Book (in the Bank column) and credit the trade receivables account (in the General Ledger). The payment will also be credited to Manfredi's account in the Receivables Ledger, as shown in **Table 2** below.

Table 2: Manfredi's account in the receivables ledger (post-payment)

Manfredi

20X0		$	20X0		$
17 Mar	Sales	6,450	16 Apr	Bank	6,450

This now completes the transaction cycle. The asset trade receivables reduces by the amount of the payment, and cash at bank increases by the same amount.

ENCOURAGING PROMPT PAYMENT/SETTLEMENT

Sometimes, the entity may give a discount if a customer pays an invoice early. This is to encourage prompt payment by the customer. This is referred to as variable consideration in IFRS 15 para 50. The entity must estimate the amount of consideration to which it will be entitled when the promised goods or services are transferred. The accounting entries therefore depend upon whether or not the entity expects the customer to take advantage of the prompt payment/settlement discount:

- *Customer is expected to take advantage of discount* For example, let's suppose that Ingrid allows a 2% settlement discount to Manfredi if the invoice is paid within 14 days – half the normal period of credit. If Ingrid expects that Manfredi will take advantage of the discount, the amount of revenue recorded is after the discount has been deducted – ie $6,321 (98%). If, subsequently, Manfredi doesn't pay within 14 days, an additional amount (ie $129 representing the discount that was not taken advantage of) is recorded once the 14 days settlemet discount period has expired.
- *Customer is not expected to take advantage of discount* In this scenario, Ingrid does not expect Manfredi to pay within 14 days, and so revenue is recognised for the full amount $6,450. However, if after the full revenue has been recognised, Manfredi then pays within the 14 days, Ingrid would reduce both the revenue and receivables initially recorded by $129 for the prompt payment/settlement discount (variable consideration). The effect is only to record revenue of $6,321.

CUSTOMER FAILS TO PAY

It may be that Manfredi does not pay by the due date. At this point Ingrid should implement her procedures to monitor and collect overdue accounts. These should be efficient, fair and legal. Ingrid may ultimately have to employ the services of a debt collector and/or resort to legal proceedings against Manfredi. These procedures are beyond the scope of this article, although some of the basics of good credit control will be covered later.

However, there may come a time when Ingrid has to accept that the amount due from Manfredi will not be collectible and is judged to be irrecoverable. This might be because, for example, Manfredi has been declared bankrupt or has disappeared and cannot be traced.

At this point, Ingrid is going to have to face the fact that her trade receivable of $6,450 is no longer the asset she thought it was because it is now no longer probable that the economic benefits associated with the transaction will flow to her. Suppose that on 28 December 20X0 Ingrid decides to write the amount off as an irrecoverable debt. This will be recorded in Manfredi's account in the Receivables Ledger as shown in **Table 3** (below).

Table 3: Manfredi's account in the receivables ledger (irrecoverable debt)

Manfredi

20X0		$	20X0		$
17 Mar	Sales	6,450	28 Dec	Irrecoverable debts	6,450
		6,450			6,450

The original entry for the write off will be in the journal:

	$	$
Dr Irrecoverable debts	6,450	
Cr Receivables control account		6,450

Invoice due from customer Manfredi written off as irrecoverable The amounts will then be posted to the double entry system by debiting irrecoverable debts and crediting trade receivables – both accounts will be in the General Ledger.

The trade receivable now ceases to be an asset and becomes an expense. The adverse effect on profit can be significant. If Ingrid sells her goods at a uniform gross margin of 30%, the effect of the non-collection of the amount due can be summarised as shown in **Table 4.**

Table 4: Ingrid sells her goods at a uniform gross margin of 30%

	$	
Sales	6,450	70% of 6,450
Cost of sales	(4,515)	
Gross profit	1,935	30% of 6,450
Irrecoverable debts	(6,450)	
Profit/(loss)	(4,515)	

Ingrid will have to make additional sales of $15,050 just to break even (30% of $15,050 = $4,515).

MAKING AN ALLOWANCE FOR RECEIVABLES

Let us now assume that the financial year end for Ingrid is 31 December 20X0. The irrecoverable debt arising from the sale to Manfredi has been recognised in the same year in which the sale was made. Ingrid may feel that it would be prudent to make an additional charge for irrecoverable debts based on the total of trade receivables as at the end of the year.

Ingrid expects that a fairly fixed percentage of trade receivables will prove to be uncollectible each year.

Suppose that Ingrid estimates that on average 3% of trade receivables will prove to be uncollectible. This means that if Ingrid's trade receivables as at 31 December 20X0 totalled $541,800 then she can expect to write off about $16,254 of this in 20X1. It would be appropriate to charge this amount as an expense in the year in which the related sales took place (the matching principle) even though Ingrid will not find out which specific receivables are uncollectible until 20X1.

Suppose now that the total trade receivables written off as irrecoverable during 20X0 was $196,201 (this will include Manfredi's debt). The total amount charged in the statement of profit or loss for 20X0 will now be:

	$
Irrecoverable debts	196,201
Add end of year allowance for receivables	16,254
Receivables expense for 20X0	212,455

And the amount included in current assets in the statement of financial position as at the end of 20X0 will be:

	$
Trade receivables	541,800
Less Allowance for receivables	16,254
	525,546

This will all be recorded in the ledger accounts as shown in **Table 5.**

Table 5: Ingrid's ledger account

Irrecoverable debts

20X0	**$**	**20X0**	**$**
Trade receivables	196,201	31 Dec Statement of profit or loss	212,455
31 Dec Allowance for receivables	16,254		
	212,455		212,455

Allowance for receivables

20X0	**$**	**20X0**	**$**
		31 Dec Irrecoverable debts	16,254

OUT WITH THE OLD AND IN WITH THE NEW

We're not quite finished yet. If 20X0 was not Ingrid's first year of operation she would have made an allowance for trade receivables at the end of 20W9. So, if Ingrid's trade receivables totalled $400,932 as at 31 December 20W9, she would have made an allowance for receivables of $12,028 (3% of $400,932). It is important that this allowance is reversed for 20X0 so that the irrecoverable debts of $12,028 anticipated and charged in 20W9 are not charged again in the statement of profit or loss for 20X0.

The total amount charged in the statement of profit or loss for 20X0 will now be:

	$
Irrecoverable debts written off	196,201
Deduct start of year allowance for receivables	(12,028)
Add end of year allowance for receivables	16,254
Receivables expense for 20X0	200,427

Effectively what we do each year is charge/credit to the statement of profit or loss the increase/decrease in the allowance for receivables at the year end. In the case above the allowance for receivables increased by $4,226 ($16,254 – 12,028) which will be charged to the receivables expense account. This may be an easier way to process through the ledger accounts – see the incremental approach below (table 7).

And the amount included in current assets in the statement of financial position as at the end of 20X0 will be unchanged:

	$
Trade receivables	541,800
Less Allowance for receivables	16,254

	$
	525,546

This will be recorded in the ledger accounts as shown in **Table 6.**

Table 6

Irrecoverable debts

20X0		**$**	**20X0**		**$**
Trade receivables		196,201	31 Dec	Allowance for receivables (old)	12,028
31 Dec	Allowance for receivables	16,254	31 Dec	Statement of profit or loss	200,427
		212,455			212,455

Allowance for receivables

20X0		**$**	**20X0**		**$**
31 Dec	Irrecoverable debts (old)	12,028	01 Jan	Balance b/f	12,028
31 Dec	Balance c/d	16,254	31 Dec	Irrecoverable debts (new)	16,254
		28,282			28,282
			20X1		
			01 Jan	Balance b/d	16,254

You will note that the allowance for the receivables account has just two entries for the year. At the end of each accounting period the old allowance is taken out and the new allowance is put in. In each case, the other entry is made in the irrecoverable debts account. This is an expense account which is closed off to the income statement each year.

The above method is relatively easy to understand if you are new to this, and it can always be relied on to get the correct figures. The charge in the statement of profit or loss will always be: receivables written off – last year's allowance for receivables + this year's allowance for receivables.

The figure in the statement of financial position will always be: trade receivables – this year's allowance for receivables.

THE INCREMENTAL APPROACH

This is an alternative way of updating the allowance for trade receivables at the end of each accounting period.

It reduces the number of entries in the ledger accounts, but is a bit more difficult to master. Using this method, the start of year allowance for receivables is just changed to give the end of year allowance. The problem is that the change in the allowance may result in an increase or a decrease.

Using the same data as before, the receivables expense charged in the statement of profit or loss for 20X0 will be:

	$
Irrecoverable debts written off	196,201
Increase in allowance for receivables	4,226
Receivables expense	200,427

The amount included in current assets in the statement of financial position as at the end of 20X0 will be as before:

	$
Trade receivables	541,800

	$
Less Allowance for receivables	16,254
	525,546

The entries in the ledger accounts will be as shown in **Table 7.**

Table 7

Irrecoverable debts

20X0		**$**	**20X0**		**$**
Trade receivables		196,201	31 Dec	Statement of profit or loss	200,427
31 Dec	Allowance for receivables (increase)	4,226			
		200,427			200,427

Allowance for receivables

20X0		**$**	**20X0**		**$**
31 Dec	Balance c/d	16,254	01 Jan	Balance b/f	12,028
			31 Dec	Irrecoverable debts (increase)	4,226
		16,254			16,254
			20X1		
			01 Jan	Balance b/d	16,254

If the allowance for receivables had been decreased, the allowance for receivables would have been debited with the decrease and the irrecoverable debts account would have been credited. Here’s an illustration. Suppose that in 20X1 receivables written off as irrecoverable totalled $166,400, and that the allowance for receivables is to be reduced to $15,000. The ledger accounts for 20X1 would be as shown in **Table 8**.

Table 8

Irrecoverable debts

20X1	$	20X1		$
Trade receivables	166,400	31 Dec	Allowance for receivables (decrease)	1,254
		31 Dec	Statement of profit or loss	165,146
	166,400			166,400

Allowance for receivables

20X1		$	20X1		$
31 Dec	Irrecoverable debts (decrease)	1,254	01 Jan	Balance b/f	16,254
31 Dec	Balance b/d	15,000			
		16,254			16,254
			20X2		
			01 Jan	Balance b/d	15,000

CREDIT CONTROL

Earlier we saw that irrecoverable debts can severely decrease profit (and cash flow). It is therefore important that a business does all it can to reduce the incidence of irrecoverable debts. Some think that good credit control is all about chasing up overdue accounts effectively. In fact, good credit control should start much earlier. The following considerations are the foundations of good credit control:

- Who gets credit? The initial screening of potential credit customers is important. A credit sale is essentially a free gift to the customer until the invoice is paid. It is no use making a credit sale to a questionable customer just to achieve the sale. The profit is more than wiped out if the customer defaults. On the other hand, over enthusiastic vetting at this stage could result in lost sales to potentially good customers.
- Terms of credit These should be set up and agreed in advance. They will include the credit limit (the maximum amount the customer can owe at any point in time), the credit period, whether discount can be claimed for quick payment, if interest is chargeable if the payment terms are not met, and so on. The terms of credit need not be the same for each customer.
- Administration of billing and collection Efficiency here will be important. Invoices should be issued quickly and should be accurate. Customers generally will not pay unless, and until, they receive the invoice, so delays in invoicing will result in delays in payment. Errors in invoices also hold things up. The payment patterns of customers should be known, if possible, and invoices issued to take advantage of these. Businesses should also review their procedures for issuing statements and reminders.

Collection of overdue accounts As mentioned earlier, procedures here need to be systematic, fair, reasonable and within the law. Avoiding the issue of non-payment, or just hopefully sending out computer generated reminders every few months, are unlikely to be effective.

On the other hand, threatening a customer might be effective but will most likely land the business in court.

FINALLY, SOME GOOD NEWS!

Having written off Manfredi's debt in 20X0, Ingrid is surprised to receive a payment of $6,450 from Manfredi in 20X1 along with a letter apologising for the delay. There are two ways to record this.

Method A

	$
Dr Bank	6,450
Cr Irrecoverable debts	6,450

Method B

	$
Dr Bank	6,450
Cr Trade receivables (and Manfredi's personal account)	6,450

And

	$
Dr Trade receivables (and Manfredi's personal account)	6,450
Cr Irrecoverable debts	6,450

The difference between the two methods is that Method B reverses the irrecoverable debt write off.

Method A might be appropriate where a full or part payment is received at the end of bankruptcy proceedings or from a debt collection agency.

Method B might be more suitable when full payment is unexpectedly received from the customer. In this situation, the business should question whether it was a bit too hasty in writing the receivable off in the first place, and review its procedures generally.

Note however that neither method adjusts revenue/sales as this was recorded in 20X0 when the actual sale took place and the materials were delivered.

Questions

IFRS 15 Revenue from Contracts with Customers sets out principles of revenue recognition. Which of the following are indicators that revenue should be recognised for the sale of goods?
(1) The seller has transferred physical possession of the goods
(2) The customer has legal title to the asset
(3) The customer has paid for the goods
(4) The customer has the significant risks and rewards of ownership

A 1, 2 and 3
B 1, 2 and 4
C 1, 3 and 4
D 2, 3 and 4

Answer: B

A contract for the sale of goods is a performance obligation that will be satisfied at the point in time when the customer obtains control of the goods. Payment for goods is not an indicator of the transfer of control.

Chapter 2 Discounts

Executive Summary

IFRS 15, Revenue from Contracts with Customers: The impact it will have on accounting for prompt payment discounts is discussed in this article

5-step approach suggested by IFRS 15

- Step 1: Identify the contract with the customer
- Step 2: Identify the performance obligations in the contract
- Step 3: Determine the transaction price
- Step 4: Allocate the transaction price to the performance obligations in the contract
- Step 5: Recognise revenue when (or as) the entity satisfies a performance obligation

Prompt payment discounts (also known as settlement or cash discounts) are offered to credit customers to encourage prompt payment of their account.

In order to recognise revenue, an entity must determine the amount of consideration it expects to be entitled to in accordance with the criteria of IFRS 15.

Per IFRS 15, the third step of the five step approach requires an entity to 'Determine the transaction price', which is the amount to which an entity expects to be entitled in exchange for the transfer of goods and services. When making this determination, an entity will consider past customary business practices.

When an entity enters into a sale with a customer and a prompt payment discount has been offered, the amount of revenue to be recognised initially will need to be estimated taking into account the probability of the discount being accepted. When the entity expects that the customer will accept the discount, revenue should be recorded net of the discount.

Offering prompt payment discounts will result in lower revenue being recognised.

IFRS 15, *REVENUE FROM CONTRACTS WITH CUSTOMERS*

In May 2014, the IASB issued IFRS 15, *Revenue from Contracts with Customers* which supersedes IAS 18, *Revenue*. It applies to all businesses reporting under IFRS for periods beginning on or after 1 January 2018. This article considers the application of IFRS 15, *Revenue from Contracts with Customers* and the impact it will have on accounting for prompt payment discounts; it is most relevant to students studying FA. Students studying FA1 and FA2 will also see prompt payment discounts but the underlying detail of IFRS 15 will be less relevant.

This new standard considers there to be a five step approach when recognising revenue:

- Step 1: Identify the contract with the customer
- Step 2: Identify the performance obligations in the contract
- Step 3: Determine the transaction price
- Step 4: Allocate the transaction price to the performance obligations in the contract
- Step 5: Recognise revenue when (or as) the entity satisfies a performance obligation

ACCOUNTING FOR DISCOUNTS

Prompt payment discounts (also known as settlement or cash discounts) are offered to credit customers to encourage prompt payment of their account. It is not guaranteed that customers will take advantage of prompt payment discounts at the point of sale as it is dependent upon whether or not credit customer pays within the settlement window.

Historically, and in accordance with IAS 18 *Revenue,* income from a credit sale in which a settlement discount has been offered has been recognised in full at the point of sale. Accounting for the settlement discount only takes place if the customer pays within the required settlement period (thus accepting the discount).The discount allowed would be recorded as an expense in the seller's statement of profit or loss and revenue would remain at the full amount.

Example: A Ltd sold goods with a list price of $1,500 on credit to a customer. A Ltd has a 30 day payment period and has offered the customer a 5% prompt payment discount if payment is made within 14 days.

Solution: In accordance with IAS 18 *Revenue,* the initial sale would have been recorded as debit Receivables $1,500 credit Revenue $1,500. If the customer pays within the 14 day settlement period the accounting entry would be Debit Cash $1,425 Debit Discounts Allowed $75 Credit Receivables $1,500. If the customer pays outwith the 14 day period, A Ltd would record the receipt as Debit Cash $1,500 Credit Receivables $1,500.

IMPACT OF IFRS 15 ON ACCOUNTING FOR PROMPT PAYMENT DISCOUNTS

The five step approach to recognising revenue as outlined above will change the way in which prompt payment discounts are accounted for. In order to recognise revenue, an entity must determine the amount of consideration it expects to be entitled to in accordance with the criteria of IFRS 15.

Per IFRS 15, the third step of the five step approach requires an entity to *'Determine the transaction price',* which is the amount to which an entity expects to be entitled in exchange for the transfer of goods and services. When making this determination, an entity will consider past customary business practices. [IFRS 15:47]

When prompt payments discounts are offered, it means that the expected consideration is variable (variable consideration) as the amount the entity will actually receive is dependent upon the customer choice as to whether it will take advantage of the discount.

Where a contract contains elements of variable consideration, the entity should estimate the amount of variable consideration to which it will be entitled under the contract. [IFRS 15:50]

The standard deals with the uncertainty relating to variable consideration by limiting the amount of variable consideration that can be recognised. Specifically, variable consideration is only included in the transaction price if, and to the extent that, it is highly probable that its inclusion will not result in a significant revenue reversal in the future when the uncertainty has been subsequently resolved. [IFRS 15:56]

When an entity enters into a sale with a customer and a prompt payment discount has been offered, the amount of revenue to be recognised initially will need to be estimated taking into account the probability of the discount being accepted. When the entity expects that the customer will accept the discount, revenue should be recorded net of the discount.

Example: J Ltd sold goods with a list Price of $2,000 on credit to a customer. J Ltd has a 30 day payment period and has offered the customer a 3% prompt payment discount if payment is made within 15 days. Based on past experience the customer is expected to take up the 3% discount.

Solution: The initial sale will be recorded as Debit Receivables $1,940 Credit Revenue $1,940. If the customer pays within the 14 day settlement period the accounting entry would be Debit Cash $1,940 Credit Receivables $1,940. If the customer does not pay within the 14 day period, when payment is made A Ltd would record this as Debit Cash $2,000 Credit Receivables $1,940 Credit Revenue $60.

As the above example highlights, the introduction of IFRS 15 will have a significant impact on the reported revenue. Offering prompt payment discounts will result in lower revenue being recognised (when the discount is accepted). This will have an impact on entities' gross profit margins. However, the net impact on profit as a whole will be the same as, by recording revenue net of the prompt payment discount, there is no longer a requirement to record a discount allowed expense in the statement of profit or loss. Prompt payment discounts are examined in FA1, FA2 and FA and so an appreciation of this impact is important.

Questions

Bumbly Co extracted the trial balance for the year ended 31 December 20X7. The total of the debits exceeded the credits by $300.
Which of the following could explain the imbalance?

A Sales of $300 were omitted from the sales day book
B Returns inward of $150 were extracted to the debit column of the trial balance
C Discounts received of $150 were extracted to the debit column of the trial balance
D The bank ledger account did not agree with the bank statement by a debit of $300

Answer: C

Chapter 3 Adjustments to Financial Statements

Executive Summary

This article is about main possible post trial balance adjustments, including:

- inventory
- accruals and prepayments
- interest
- depreciation
- bad debts and allowances for receivables/debtors.

All these adjustments have an impact on both the statement of profit or loss and in the statement of financial position.

Inventory:

- The cost of sales consists of opening inventory plus purchases, minus closing inventory. The closing inventory is thus a deduction (credit) in the statement of profit or loss, and a current asset (debit) in the statement of financial position.

Accruals & prepayments:

- Unpaid balances relating to the period should be included in the statement of financial position as current liabilities. If the expense has been paid in advance, the amount prepaid is included in the statement of financial position as a current asset.

Depreciation:

- Depreciation spreads the cost of non-current/ over the assets' useful lives, so that a charge against profit appears in the statement of profit or loss.

Bad debts and allowance for receivables/debtors:

- These adjustments probably cause most difficulty for candidates in an examination. Bad debts writing off a bad debt means taking a customer's balance in the receivables ledger and transferring it to the statement of profit or loss as an expense, because the balance has proved irrecoverable.

Many candidates are unable to handle certain adjustments properly in the exam. This article explains how to treat the main possible post trial balance adjustments, including:

- inventory
- accruals and prepayments
- interest
- depreciation
- bad debts and allowances for receivables/debtors.

The most important point, which must be understood at the outset, is that all these adjustments have an impact on both the statement of profit or loss and in the statement of financial position. If the trial balance balances, your answer must balance, and therefore any changes you make to the trial balance must balance – every debit adjustment should have an equal and opposite credit adjustment. Having said that, it is more important to complete the question within the time allowed, without spending time on getting the statement of financial position to balance.

INVENTORY

This is a fairly familiar adjustment. The cost of sales consists of opening inventory plus purchases, minus closing inventory. The closing inventory is thus a deduction (credit) in the statement of profit or loss, and a current asset (debit) in the statement of financial position. The ledger account behind the adjustment causes problems for some candidates. This is how the inventory/stock account will look at the time the trial balance is being prepared. The entry is the transfer from the statement of profit or loss for the closing inventory of the previous year (figures invented):

Inventory

20X4	$		
31 Dec Statement of profit or loss	38,000		

In the current year, last year's closing inventory is this year's opening inventory. It must be transferred out to this year's statement of profit or loss, before the entry for the new closing inventory is made:

Inventory

20X4	$	20X5	$
31 Dec Statement of profit or loss	38,000	31 Dec Statement of profit or loss	38,000
20X5			
31 Dec Statement of profit or loss	45,000		

So if purchases had been $280,500 during the year, the cost of sales figure in the 20X5 statement of profit or loss would be $38,000 + 280,500 – 45,000 = $273,500.

There will sometimes be a requirement to adjust inventory to allow for damaged or slow-moving items. IAS 2, *Inventories* require inventories to be included at the lower of cost and net realisable value. It may therefore be necessary to reduce the inventory figure to reflect a net realisable value below cost for the items detailed. You should calculate the closing inventory figure before you process the adjustment. Writing down inventory to net realisable value will increase cost of sales and reduce inventory on the statement of financial position. Using the above, if inventory costing $10,000 is expected to sell for $5,000, you would reduce closing inventory to $45,000 – 5,000 = $40,000. Cost of sales now becomes $278,500.

ACCRUALS AND PREPAYMENTS

The statement of profit or loss has to include the expenses relating to the period, whether or not they have been paid. The figures in the trial balance will usually be the amounts paid in the period, and they need adjusting for outstanding amounts and amounts paid which relate to other periods to obtain the charge in the statement of profit or loss. Unpaid balances relating to the period should be included in the statement of financial position as current liabilities. If the expense has been paid in advance, the amount prepaid is included in the statement of financial position as a current asset. In the statement of profit or loss, the total expense is needed with a working showing the detail. Don't show two figures in the outer column for the same expense heading. For example, the trial balance shows:

	$
Wages	136,000
Insurance	4,000

At 31 December 20X5, wages owing amounted to $3,800, and insurance paid in advance was $600. This is presented as follows:

Statement of profit or loss	$
Wages (136,000 + 3,800)	139,800
Insurance (4,000 – 600)	3,400

Statement of Financial Position	$
Current assets	
Inventory/stock	–
Receivables/debtors	–
Prepayments	600
Cash	–

Statement of profit or loss	$
Current liabilities	
Trade payables/creditors	–
Accruals	3,800

The underlying ledger accounts

Wages

	$		$
Cash	136,000	31 Dec Transfer to profit or loss	139,800
Accruals	3,800		
	139,800		139,800

Insurance

	$		$
Cash	4,000	Prepayments	600
		31 Dec Transfer to profit or loss	3,400
	4,000		4,000

Similar adjustments may be needed for income, such as rent receivable. Be careful here. Income received in advance is a liability and should be included alongside accruals for unpaid expenses, thereby changing the heading to 'Accruals and deferred income'. Income in arrears is an asset which should be included with prepayments using the heading 'Prepayments and accrued income'.

INTEREST

Interest payable is really another accrual but there are one or two special points. First, the question may not give explicit instructions to accrue for interest. The trial balance may contain:

	Dr $	Cr $
8% Loan stock/debentures		100,000
Interest on loan stock/debentures	4,000	

Candidates are expected to note that only half the loan interest has been paid, and accrue for the other $4,000. Examiners generally indicate in some way that the loan stock/debentures have been in issue for the whole year if they want this adjustment to be made. Second, the interest is a finance cost in the statement of profit or loss ($8,000) and the accrued interest ($4,000) is a current liability and the loan stock/debentures ($100,000) are a non-current liability. Present them appropriately and don't combine them.

DEPRECIATION

Depreciation is a slightly more complex adjustment. Depreciation spreads the cost of non-current/ over the assets' useful lives, so that a charge against profit appears in the statement of profit or loss. This charge, each year that the asset is used by the business, should match the economic benefits that the assets use has generated for the business. If an asset will help the business create revenue for 5 years, then the cost of the asset is spread over the same five years – depreciation is the application of the accruals concept. **Methods of depreciation** There are two main methods of depreciation which are tested in the Foundation level exams:

- straight line method – a percentage of cost (or cost less residual value) is charged each year
- reducing balance method – a percentage is charged on the carrying amount (cost less accumulated depreciation to date).

Depreciation policies Some businesses adopt a policy of charging a full year's depreciation in the year the asset was purchased, and none in the year of its sale. Others take proportionate depreciation for the number of months of ownership of the asset in the year. The first requirement, therefore, is to read the question carefully to find out what has to be done for each non-current asset. **Statement of profit or loss** The current year's depreciation charge is calculated and appears as an expense. Do not include the accumulated depreciation. The accumulated depreciation is the total depreciation charged during an asset's life (assuming no revaluation) and as such previous depreciation will have been charged against profits in earlier periods. **Statement of financial position** The statement of financial position shows the cost, accumulated depreciation (the figure in the trial balance brought forward from the end of the previous accounting period, plus the current year's charge from the statement of profit or loss), and the carrying amount. The easiest way to present this is as a table, as follows (figures invented):

	Cost $	Accumulated depreciation $	Carrying amount $
Buildings	800,000	80,000	720,000
Plant and equipment	390,000	260,000	130,000
Motor vehicles	210,000	100,000	111,000
	1,400,000	440,000	960,000

The underlying ledger accounts It would be possible to use just one account for each non-current asset, showing cost and accumulated depreciation. However, they are usually kept separate, in order to present the separate figures in the statement of financial position as shown above. This results in (figures invented):

Plant and machinery – cost

	$		$
Balance brought down	360,000	Balance carried down	390,000
Cash	30,000		
	390,000		390,000
Balance brought down	390,000		

Plant and machinery – accumulated depreciation

	$		$
Balance carried down	260,000	Balance brought down	221,000
		Statement of profit or loss	39,000
	260,000		260,000
		Balance brought down	260,000

A third account is required to handle disposals. When a non-current asset is sold, the cost and accumulated depreciation relating to the asset are transferred out of the accounts to a disposal account. The proceeds of sale are credited to the account, and the balance on the account is then the profit or loss on the sale, to be transferred to the statement of profit or loss. You can check your calculation of profit or loss on disposal quickly by taking the proceeds of sale less the carrying amount (cost – accumulated depreciation) of the asset at the date of sale.

BAD DEBTS AND ALLOWANCE FOR RECEIVABLES/DEBTORS

These adjustments probably cause most difficulty for candidates in an examination. **Bad debts**Writing off a bad debt means taking a customer's balance in the receivables ledger and transferring it to the statement of profit or loss as an expense, because the balance has proved irrecoverable. There are two separate exam possibilities here:

- bad debts appear as an item in the trial balance. This means the debts have already been written off. In other words, receivables have already been reduced. All that is necessary is to put the figure in the statement of profit or loss as an expense
- bad debts appear as an adjustment outside the trial balance. An adjustment to two figures are now needed. The amount goes into the statement of profit or loss as an expense (it may be added to administrative expenses or operating expenses) and is deducted from the receivables figure in the statement of financial position.

Allowance for receivables/debtors This allowance is set up in order to include a realistic value for receivables in the statement of financial position, without actually writing off the debt. The balance is left in the receivables ledger so that collection procedures continue, but the receivables in the statement of financial position are valued as if the amount is not to be recovered. The trial balance shows:

	Dr $	Cr $
Trade receivables/debtors	180,000	
Allowance for receivables/debtors		4,000

This means that the business already has an allowance brought forward from last year's statement of financial position. If nothing more is to be done, this should show in the statement of financial position, under current assets:

Trade receivables/debtors	180,000
Less: Allowance for receivables	4,000
	176,000

Alternatively, if preparing a company statement of financial position for publication, it should show: **Trade receivables (180,000 – 4,000) 176,000** The figures in brackets are a working, not part of the statement of financial position. Continuing the example, it is more likely that the question will require the allowance to be adjusted. Let us say that the allowance is to be increased to $5,400. Given that there is already $4,000, $1,400 should be charged to this year's statement of profit or loss. The result is:

Statement of profit or loss	$
Increase in allowance for receivables	1,400

Remember that it is only the increase or decrease in the allowance that goes into the statement of profit or loss.

Statement of financial position	
Trade receivables	180,000
Less: Allowance for receivables	5,400
	174,600

The underlying ledger accounts There are several ways of dealing with bad debts, and allowances for receivables, in ledger accounts. One way is to have both in one account. However, for examination purposes, it may be easier to have two accounts, one for debts written off and one for the allowance:

Bad debts (eg $17,100 written off)

	$		$
Bad debts written off	17,100	31 Dec Transfer to profit or loss	18,500
Increase in allowance	1,400		
	18,500		18,500

Allowance for receivables

	$		$
Balance carried down	5,400	Balance brought down	4,000
		Increase in allowance	1,400
	5,400		5,400

Bad debts recovered Sometimes, a debt written off in one year is actually paid in the next year – a debit to cash and a credit to bad debts recovered. The credit balance on the account is then transferred to the credit of the statement of profit or loss (added to gross profit or included as a negative in the list of expenses). This is may be clearer than crediting the recovery to the bad debts expense account, because that would obscure the expense from bad debts for the year. However if the amounts are small compared to the other expenses in the statement of profit or loss, it would not be incorrect. Make sure you read the question for instructions on how the business records such events.

Questions

(1) A company values its inventory using the FIFO method. At 1 May 20X5 the company had 700 engines in inventory, valued at $190 each. During the year ended 30 April 20X6 the following transactions took place:
20X5
1 July Purchased 500 engines at $220 each
1 November Sold 400 engines for $160,000

20X6
1 February Purchased 300 engines at $230 each
15 April Sold 250 engines for $125,000

What is the value of the company's closing inventory of engines at 30 April 20X6?
A $188,500
B $195,500
C $166,000
D $106,000

Answer: A
Closing inventory:

50 x $190 =	$9,500
500 x $220 =	$110,000
300 x $230 =	$69,000
	$188,500

(2) At 1 July 20X6 a company had a loss allowance for receivables of $83,000. During the year ended 30 June 20X7 debts totalling $146,000 were written off. At 30 June 20X7 it was decided that $218,000 was required as a loss allowance for receivables. What is the total amount that should appear in profit or loss for the year ended 30 June 20X7 for irrecoverable debts?

A $11,000
B $155,000
C $281,000
D $364,000

Answer: C

146,000 + 218,000 – 83,000 = $281,000

Chapter 4 Cash Flow Statements

Executive Summary

This article considers the statement of cash flows of which it assumes no prior knowledge.

The article will explain how to calculate cash flows and where those cash flows are presented in the statement of cash flows.

Cash flows are either receipts or payments.

Cash flows are usually calculated as a missing figure.

IAS 7, *Statement of Cash Flows* requires an entity to present a statement of cash flows as an integral part of its primary financial statements.

A statement of cash flow classifies and presents cash flows under three headings:

(i) Operating activities

(ii) Investing activities and

(iii) Financing activities

This article considers the statement of cash flows of which it assumes no prior knowledge. It is relevant to the FA (Financial Accounting) and FR (Financial Reporting) exams. The article will explain how to calculate cash flows and where those cash flows are presented in the statement of cash flows.

Computing cash flows

Cash flows are either receipts (ie cash inflows and so are represented as a positive number in a statement of cash flows) or payments (ie cash out flows and so are represented as a negative number using brackets in a statement of cash flows).

Cash flows are usually calculated as a missing figure. For example, when the opening balance of an asset, liability or equity item is reconciled to its closing balance using information from the statement of profit or loss and/or additional notes, the balancing figure is usually the cash flow.

Common cash flow calculations include the tax paid, which is an operating activity cash out flow, the payment to buy property plant and equipment (PPE) which is an investing activity cash out flow and dividends paid, which is a financing activity cash out flow. The following examples illustrate all three of these examples.

Exercise calculating the tax paid

At the start of the accounting period the company has a tax liability of $50 and at the reporting date a tax liability of $90. During the year the tax charged in the statement of profit or loss was $100.

Required: Calculate the tax paid.

Solution It is necessary to reconcile the opening tax liability to the closing tax liability to reveal the cash flow – the tax paid - as the balancing figure. A vertical presentation of the numbers lends itself to noting the source of the numbers.

Tax liability	$	Explanation
Opening balance	50	Credit balance
Tax charge	100	The tax charged in the profit or loss means that the entity now owes more tax. The debit charged as the expense in profit or

Tax liability	**$**	**Explanation**
		loss is posted and a credit to the tax liability account reflects the effect of increase in the tax liability
	____	
Sub-total	150	This sub-total represents the amount of the tax liability that there would have been at the reporting date in the event that no tax had been paid
Cash flow – the payment of tax	60	This is the last figure written in the reconciliation. It is the balancing figure and explains why the actual year-end tax liability is smaller than the sub-total
	____	
Closing balance	90	This is the closing balance of the tax liability
	____	

This simple technique of taking the opening balance of an item (in this case the tax liability) and adding (or subtracting) the non-cash transactions that have caused it to change, to then reveal the actual cash flow as the balancing figure, has wide application.

Exercise calculating the payments to buy PPE

At the start of the accounting period the company has PPE with a carrying amount of $100. At the reporting date the carrying amount of the PPE is $300. During the year depreciation charged was $20, a revaluation surplus of $60 was recorded and PPE with a carrying amount of $15 was sold for $20.

Required: Calculate the cash paid to buy new PPE.

Solution Here we can take the opening balance of PPE and reconcile it to the closing balance by adjusting it for the changes that have arisen in period that are not cash flows. The balancing figure is the cash spent to buy new PPE.

PPE	$	Explanation
Opening balance	100	Debit balance
Deprecation	(20)	Deprecation reduces the carrying amount of the PPE without being a cash flow. The double entry for depreciation is a debit to statement of profit or loss to reflect the expense and to credit the asset to reflect its consumption.
Revaluation surplus	60	The revaluation gain increases PPE without being a cash flow. The double entry is a credit to the revaluation surplus to reflect the gain and to debit the asset to reflect its increase
Disposal	(15)	The carrying amount of the PPE that has been disposed of reduces the PPE thus a credit to the asset account which is then posted as a debit in the disposals account
	_____	
Sub-total	125	This sub-total represents the balance of the PPE if no PPE had been bought for cash
Cash flow – the payment to buy PPE	175	This is the last figure written in the reconciliation This balancing figure explains why the actual PPE at the reporting date is greater than the sub-total
	_____	
Closing balance	300	
	_____	

Note that the cash proceeds ffrom the disposal of PPE ($20) would be shown separately as a cash inflow under investing activities. The profit on disposal of $5 ($20–$15) would be adjusted for as a non-cash item under the operating activities (see later).

Exercise calculating the dividend paid

At the start of the accounting period the company has retained earnings of $500 and at the reporting date retained earnings are $700. During the reporting period a profit for the year of $450 was reported.

Required: Calculate the dividend paid.

Solution As before, to ascertain the cash flow – in this case dividends paid - we can reconcile an opening to closing balance – in this case retained earnings. This working is in effect an extract from the statement of changes in equity.

Retained earnings	$	Explanation
Opening balance	500	Credit balance
Profit for the year	450	The profit for the year is a credit and increases the retained earnings
	_____	
	950	This sub-total represents the balance on retained earnings in the event that no dividends have been paid
Cash flow – the dividends paid	250	This is the last figure written in the reconciliation. This balancing figure of dividends paid explains why the actual year-end retained earnings is less
	_____	
Closing balance	700	

Retained earnings	$	Explanation

Classification of cash flows

IAS 7, *Statement of Cash Flows* requires an entity to present a statement of cash flows as an integral part of its primary financial statements. A statement of cash flow classifies and presents cash flows under three headings:

(i) Operating activities (ii) Investing activities and (iii) Financing activities

Operating activities can be presented in two different ways. The first is the direct method which shows the actual cash flows from operating activities – for example, the receipts from customers and the payments to suppliers and staff. The second is the indirect method which reconciles profit before tax to cash generated from operating profit. Under both of these methods the interest paid and taxation paid are then presented as cash outflows deducted from the cash generated from operations.

Investing activity cash flows are those that relate to non-current assets including investments. Examples of investing cash flows include the cash outflow on buying property plant and equipment, the sale proceeds on the disposal of non-current assets and any cash returns received arising from investments.

Financing activity cash flows relate to cash flows arising from the way the entity is financed. Entities are financed by a mixture of cash from borrowings from third parties (debt) and by the shareholders (equity). Examples of financing cash flows include the cash received from new borrowings or the cash repayment of debt as well as the cash flows with shareholders in the form of cash receipts following a new share issue or the cash paid to them in the form of dividends.

This topic is examined in much more depth in the FR examination than it is at FA. For example, in FA, an extract, or the whole statement of cash flow might be required in the multi-task questions but it could also be constructed as an OT question. FR, however, is more likely to ask for an extract from the statement of cash flows using more complex transactions (for example, the purchase of PPE using right-of-use asset leases). However, that does not mean that FR will never require the preparation of a complete statement of cash flows so be prepared.

Operating activities – the indirect method and direct method

There are two different ways of starting the cash flow statement, as IAS 7, *Statement of Cash Flows* permits using either the 'direct' or 'indirect' method for operating activities.

The direct method is intuitive as it means the statement of cash flow starts with the source of operating cash flows. This is the cash receipts from customers. The operating cash out flows are payments for wages, to suppliers and for other operating expenses which are deducted. Finally the payments for interest and tax are deducted.

Alternatively, the indirect method starts with profit before tax rather than a cash receipt. The profit before tax is then reconciled to the cash that it has generated. This means that the figures at the start of the cash flow statement are not cash flows at all. In that initial reconciliation the profit before tax is adjusted for expenses that have been charged against profit that are not cash out flows; for example depreciation and losses on disposal of non-current assets, have to be added back, and non-cash income; for example, investment income and profits on disposal of non-current assets are deducted. The changes in inventory, trade receivables and trade payables (working capital) do not impact on the measurement profit but these changes will have impacted on cash and so further adjustments are made. For example, an increase in the levels of inventory and receivables will have not impacted on profit before tax but will have had an adverse impact on the cash flow of the business. Thus, in the reconciliation process, the increases in inventory and trade receivables are deducted from profit before tax. Conversely, decreases in inventory and trade receivables are added back to the profit before tax. The opposite is applicable for trade payables. Finally, the payments for interest and tax are presented – usually as a further deduction.

The following exercise illustrates both the direct and indirect methods operating activities section.

Exercise: The direct and indirect method

Extracts from the financial statements are as follows

	$
Operating profit	80,000
Investment income	12,000
Finance costs	(10,000)

	$
Profit before tax	82,000
Tax	(32,000)
Profit for the year	50,000
Other comprehensive income	
Revaluation gain	40,000
Total comprehensive income	90,000

	Closing balance $	Opening balance $
Current assets		
Inventory	30,000	25,000
Receivables	20,000	26,000
Current liabilities		
Trade payables	14,000	11,000

Additional information During the year depreciation of $50,000 and amortisation of $40,000 was charged to profit.

Receipts from customers, combined with cash sales, were $800,000, payments to suppliers of raw materials $400,000, other operating cash payments were $100,000 and cash paid on behalf and to employees was $126,000.

Interest paid is $12,000 and taxation paid is $13,000.

Required: (a) Using the direct method prepare the operating activities section of the statement of cash flows. (b) Using the indirect method determine the operating activities section of the statement of cash flows.

Answer (a) direct method The direct method is relatively straightforward in that all the data are cash flows so it is really just a case of listing the receipts as positive and the payments as negative.

Operating activities – Direct method	$
Cash received from customers	800,000
Cash paid to suppliers	(400,000)
Cash paid to staff	(126,000)
Other operating payments	(100,000)
Cash generated from operations	174,000
Interest paid	(12,000)
Taxation paid	(13,000)
Net cash from operating activities	149,000

Answer (b) indirect method The indirect method is more commonly examined. Here as we start with profit before tax we have to add back all the non-cash expenses charged, deduct the non-cash income and adjust for the changes in working capital. Only then are the two actual cash flows of interest paid and tax paid presented. Having a good understanding of the format of the statement of cash flows is key to a successful attempt at these questions.

Operating activities – Indirect method	$
Operating activities	
Profit before tax	82,000
Investment income	(12,000)
Finance cost	10,000
Depreciation	50,000
Amortisation	40,000
Increase in inventory (30,000 – 25,000)	(5,000)
Decrease in receivables (20,000 – 26,000)	6,000
Increase in payables (14,000 – 11,000)	3,000
Cash generated from operations	174,000

Operating activities – Indirect method	$
Interest paid	(12,000)
Taxation paid	(13,000)
Net cash from operating activities	149,000

Note how whichever method is used that the same cash is generated from operating activities.

Format of the cash flow statement – indirect method

You may be asked to prepare a statement of cash flows. The following is a pro forma showing the indirect method.

1. Operating activities	
Profit before tax	X
Investment income	(X)
Finance cost	X
Depreciation	X
Less capital government grant released	(X)
Amortisation of intangible assets	X

Impairment loss charged in profit or loss	X
Loss on disposal of assets (profit)	X/(X)
Increase in provisions (decrease)	X/(X)
Changes in working capital	
Increase / decrease in inventory	X/(X)
Increase / decrease in receivables and prepayments	X/(X)
Increase / decrease in trade payables and accruals	X/(X)
Cash generated from operations	X
Interest paid	(X)
Taxation paid	(X)
Net cash from operating activities	X
2. Investing activities	
Payments to buy PPE / Intangibles / Investments	(X)
Proceeds from sale of PPE / Intangibles / Investments	X
Dividends received from investments	X

Capital government grants received	X
Net cash used in investing activities	X
3. Financing activities	
Proceeds from an equity share issue	X
Dividends paid	(X)
Proceeds from the issue of new debt	X
Repayment of debt	(X)
Capital repayment of finance lease obligations	(X)
Net cash from/used in financing activities	X/(X)
Change in cash and cash equivalents	X/(X)
Opening cash and cash equivalents	X/(X)
Closing cash and cash equivalents	X/(X)

Cash and cash equivalents comprise cash on hand and demand deposits, together with short-term, highly liquid investments that are readily convertible to a known amount of cash, and that are subject to an insignificant risk of changes in value. A bank overdraft should be treated as a negative cash balance when arriving at the cash and cash equivalents.

Questions

Which of the following items could appear in a company's statement of cash flows?
(1) Proposed dividends
(2) Rights issue of shares
(3) Bonus issue of shares
(4) Repayment of loan
A 1 and 3
B 1 and 4
C 2 and 3
D 2 and 4

Answer: D
Proposing dividends and issuing bonus shares are not cash flow transactions.

Chapter 5 Preparing Simple Consolidated Financial Statements

Executive Summary

The FA syllabus examines the principles contained in:

- IAS 27, Separate Financial Statements
- IAS 28, Investments in Associates and Joint Ventures
- IFRS 3, Business Combinations
- IFRS 10, Consolidated Financial Statements

Note: FA syllabus only includes the accounting for associates but not joint ventures.

Main principles of consolidated financial statements that a candidate must be able to understand and gives examples of how they may be tested in objective test questions (OTs) and multi-task questions (MTQs).

IFRS 10 states control arises when the investor (the parent) has:

i. power over the investee (the subsidiary)
ii. exposure, or rights, to variable returns from its involvement with the investee, and
iii. the ability to use its power over the investee to affect the amount of the investors returns.

In this article, the following items are shared:

1. Determine of a subsidiary
2. Intra-group transactions
3. Adjustments for unrealised profits
4. How is goodwill calculated?
5. What is an associate and how does equity accounting work?

At Paper FA, a good solid platform of understanding the principles of consolidation is required.

The FA syllabus examines the principles contained in:

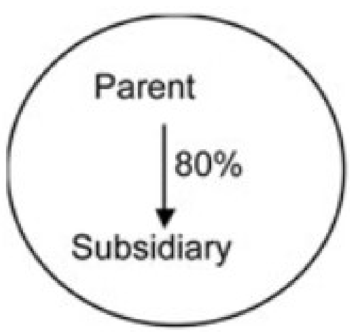
- IAS 27, *Separate Financial Statements*
- IAS 28, *Investments in Associates and Joint Ventures*
- IFRS 3, *Business Combinations*
- IFRS 10, *Consolidated Financial Statements*

Please note the syllabus does not cover Joint Ventures but IAS 28 is applicable to Associates which are covered.

This article focuses on some of the main principles of consolidated financial statements that a candidate must be able to understand and gives examples of how they may be tested in objective test questions (OTs) and multi-task questions (MTQs).

It does not attempt to cover every technical aspect of consolidation, but to give candidates the tools they need to prepare for the style and level of testing, they can expect to see in this paper.(1) How is a parent-subsidiary relationship identified? IAS 27 defines consolidated financial statements as 'the financial statements of a group presented as those of a single economic entity.' A group is made up of a parent and its subsidiary.

Illustration 1 shows an example of a typical group structure.



The illustration shows how a parent company has control over a subsidiary. At Paper FA level, it is assumed that control exists if the parent company has more than 50% of the ordinary (equity) shares – ie giving them more than 50% of the voting power.

However, there are examples where a holding of less than 50% of the ordinary shares can still lead to control existing. IFRS 10 states control arises when the investor (the parent) has:

i. power over the investee (the subsidiary)

ii. exposure, or rights, to variable returns from its involvement with the investee, and

iii. the ability to use its power over the investee to affect the amount of the investors returns.

Power may be evidenced by all or some of the following:

- the power over more than 50% of the voting rights by virtue of agreement with other investors
- the power to govern the financial and operating policies of the entity under statute or an agreement
- the power to appoint or remove the majority of the members of the board of directors, or
- the power to cast the majority of the votes at meetings of the board of directors.

A typical OT may describe a number of different investments and you would need to decide if they are subsidiaries – ie if control exists. Illustration 2 is an example of a typical question.

Illustration (2) Green Co owns the following investments in other companies:

	Equity shares	Non-equity shares held
Violet Co	80%	Nil
Amber Co	25%	80%
Black Co	45%	25%

Green Co also has appointed five of the seven directors of Black Co.

Which of the following investments are accounted for as subsidiaries in the consolidated accounts of Green Co Group?

A Violet only **B** Amber only **C** Violet and Black **D** All of them

Answer

Let's consider each of the investments in turn to determine if control exists and, therefore, if they should be accounted for as a subsidiary.

- Violet Co – by looking at the equity shares, Green Co has more than 50% of the voting shares – ie an 80% equity holding. This gives them control and, therefore, Violet Co is a subsidiary.

- Amber Co – you must remember to look at the equity shares, as despite having the majority of the non-equity shares, these do not give voting power. As Green Co only has 25% of the equity shares, they do not have control and, therefore, Amber Co is not a subsidiary.

- Black Co – by looking at the percentage of equity shares, you may incorrectly conclude that Black Co is not a subsidiary, as Green Co has less than half of the voting rights. However, by looking at the fact that Green Co has appointed five of the seven directors, effectively they have the power, and ability to use that power, to affect the decision making in the company which will impact on the returns to be made. This should make you conclude that Black Co is a subsidiary.

Therefore the correct answer is C.

Illustration (3) Pink Co acquired 80% of Scarlett's Co ordinary share capital on 1 January 20X2.

As at 31 December 20X2, extracts from their individual statements of financial position showed:

	Pink C $	Scarlett Co $
Current assets: Receivables	50,000	30,000
Current liabilities: Payables	70,000	42,000

As a result of trading during the year, Pink Co's receivables balance included an amount due from Scarlett of $4,600.

What should be shown as the consolidated figure for receivables and payables?

	Receivables $	Payables $
A	80,000	112,000
B	75,400	112,000
C	74,000	103,600
D	75,400	107,400

Answer From the question, we can see that Pink Co has control over Scarlett Co. This should mean that you immediately consider adding together 100% of Pink Co's balances and Scarlett Co's balances to reflect control.

However, the intra-group balances at the year end need to be eliminated, as the consolidated accounts need to show the group as a single economic entity. The group statement of financial position should only include amounts owed and owing to entities outwith the group. As Pink Co shows a receivable of $4,600, then in Scarlett Co's individual accounts there must be a corresponding payable of $4,600. When these balances are eliminated, the consolidated figures become:

Receivables ($50,000 + $30,000 – $4,600) = $75,400 Payables ($70,000 + $42,000 – $4,600) = $107,400

Therefore, the correct answer is D, not A which completely omits the elimination of the intra-group balances, nor answer B which omits to cancel the corresponding payable within liabilities.

You would not select answer C, which incorrectly adds 100% of Pink Co (the parent) and only 80% of Scarlett Co (the subsidiary). Although Pink Co only owns 80% of Scarlett Co, it controls 100%. Consolidated financial statements reflect control, not ownership. It would be a fundamental mistake in any consolidation question to ever pro-rate a subsidiaries statement of financial position where there is less than 100% ownership.

(3) Adjustments for unrealised profits

Another common adjustment that you could be asked to deal with is the removal of unrealised profit. This arises when profits are made on intra-group trading and the related inventories have not subsequently been sold to customers outside the group. Until inventory is sold to entities outwith the group, any profit is unrealised and should be eliminated from the consolidated accounts.

The following illustration demonstrates this in the context of the consolidated statement of profit or loss.

Illustration (4)

Purple Co acquired 70% of the voting share capital of Silver Co on 1 October 20X1.

The following extracts are from the individual statements of profit or loss of the two companies for the year ended 30 September 20X2:

	Purple Co $	Silver Co $
Revenue	79,300	29,900
Cost of sales	(54,990)	(17,940)
Gross profit	24,310	11,960

Purple Co had made sales to Silver Co during the year of $5,000. Purple Co had originally purchased the goods at a cost of $4,000. Half of these items remained in the inventory of Silver Co at the year end.

What should be the consolidated revenue for the year ended 30 September 20X2?

A $104,700 **B** $95,230 **C** $108,700 **D** $104,200

Answer Even though this question requires an extract from the consolidated statement of profit or loss, the principle is still the same as Illustration (3) – consolidate the group as if it is a single economic entity by adding in 100% line by line, and showing group performance with all non-group entities.

Therefore, answer B would not be selected as it incorrectly adds 100% of Purple Co and only 70% of Silver Co.

The other adjustment that requires careful consideration is the intra-group trading. In the consolidated statement of profit or loss we must always consider two steps:

- Has there been any intra-group trading during the year, irrespective of whether the goods are still included in inventory at the year end?
- Do any of the items remain in inventory at the end of the year?

In this question, $5,000 of sales have been made from Purple Co selling to Silver Co. This must be eliminated, irrespective of whether the items remain unsold at the year end. This is because the consolidated statement of profit or loss needs to show revenue and costs of sales which reflects group performance with external, non-group, entities.

The second step here is to identify the provision for unrealised profit (PUP). Note although we refer to this as a provision, it is not a liability but an adjustment to the asset, inventory. Purple Co has made a profit of $1,000 (calculated as revenue of $5,000 – cost of $4,000). As only half of the items remain in inventory, the inventory value is overstated by half of that profit – that is, $500. Note: in many Paper FA questions, you will be expected to calculate the profit made by using margins or mark-ups, which are not discussed here.)

The consolidation adjustment is saying that the group has made a profit of $500 on items, which have not been sold on to a third party/non-group entity. Effectively if you did not make an adjustment for PUP the group would be recording a profit of $500 selling inventory to itself. This inflates the value of the inventory held by the group in the statement of position and the profit in the statement of profit or loss.

The adjustment would be:

Dr. Cost of sales	$500	Cr. Inventory (SoFP)	$500

However, by reading the question stem carefully, you will see that eliminating the unrealised profit is a red herring, as we are being asked for consolidated revenue.

Therefore, the consolidated revenue is calculated as:

$79,300 + $29,900 – $5000 = $104,200

The correct answer is D.

Had the question stem asked for the consolidated cost of sales figure, the answer would be correctly calculated as:

$54,990 + $17,940 + $500 – $5,000 = $68,430

The PUP is added back to cost of sales, which reduces/eliminates the profit. (Effectively what you are doing is adjusting the closing inventory that is part of the cost of sales figure).

Note: Answer A is incorrect, as although it correctly cancels the intra-group sale of $5,000, it incorrectly adds the $500 adjustment for unrealised profit to the revenue figure ($79,300 + $29,900 – $5,000 + $500 = $104,700)

Answer C is also incorrect because it omits the cancelling of $5,000 sales and deals incorrectly with the provision for unrealised profit of $500. ($79,300 + $29,900 – $500 = $108,700).

(4) How is goodwill calculated?

Another typical FA exam question will require you to calculate goodwill.

Under this syllabus, only the full goodwill method is examinable and is calculated as:

		$
(1)	Fair value of consideration transferred	X

		$
(2) plus:	Fair value of non-controlling interest	X
(3) less:	Fair value of net assets at acquisition	X
	Goodwill at acquisition	**X**

This could be asked as an OT question but is more likely to be a MTQ where you will be calculating and submitting a figure for each of the component parts of the good will calculation – cost, NCI and net assets. You should look at the specimen paper and extra MTQs available on the ACCA website.

Even though we only own 80% of the share capital, the full goodwill method brings 100% of the goodwill on to the consolidated statement of financial position. This is consistent with the treatment of other assets and the concept of control. This is why we need to include the fair value of the non-controlling interest in our goodwill calculation. See Illustration 5 below for a typical MCQ on goodwill.

Illustration (5) Red Co acquired 80% of Blue Co's 40,000 $1 ordinary share capital on 1 January 20X2 for a consideration of $3.50 cash per share.

The fair value of the non-controlling interest was $30,000 and the fair value of the net assets acquired was $125,000.

What should be recorded as goodwill on acquisition of Blue Co in the consolidated financial statements? A $17,000 **B** $45,000 **C** $42,000 **D** $112,000

Answer Goodwill can be tested in a variety of different ways (see above). Always start by reading the question requirement carefully to determine what is being asked for. Here, in this specific OT question, it is the goodwill on acquisition that is being asked for, whereas other questions may ask for the cost of investment that would be recorded in the parent's books.

If we consider each component in turn, the first thing to identify is how much the parent company has paid to acquire control over the subsidiary. In this question, Red Co acquires control by paying $3.50 cash per share.

Note: Red Co has only acquired 80% of Blue Co's shares, so consideration transferred is 80% x 40,000 = 32,000 x $3.50 = $112,000.

Had the question asked for the cost of the investment that would be recorded in the parent's books this would be it – hence the inclusion of the distracter, and incorrect answer D.

Secondly, once we have identified the amount of consideration transferred to acquire control over the subsidiary, the fair value of the non-controlling interest needs to be identified. In this question the fair value of the non-controlling interest is given, so in our calculation we just need to add it to the consideration transferred. In a MTQ it is likely you would be given the value of a NCI share and have to apply it to the 8,000 shares that Red did not acquire.

In the final part of the calculation, following on from the point just made, it is necessary to look at all (100%) of the fair value of net assets at acquisition. Again this figure is given in this question and just requires slotting into our goodwill working. In other MTQs, you may be expected to do more work on finding the fair value of the net assets at acquisition.

Goodwill can then be calculated as:

	$
Consideration transferred	112,000
Plus: Non-controlling interest	30,000
	142,000

	$
Less: fair value of net assets at acquisition	(125,000)
Goodwill at aquisition	**17,000**

The correct answer is A.

Note: Answer B ignores that Red Co only acquired 80% of the shares and calculates the cost of investment incorrectly as 40,000 x $3.50 = $140,000 – therefore, goodwill of $140,000 + $30,000 – $125,000 = $45,000.

Answer C is incorrect as, despite calculating the cost of investment correctly as $112,000 + non controlling interest of $30,000 = $142,000, it incorrectly deducts (80% x $125,000) as the share of net assets at acquisition giving goodwill of $42,000.

(5) What is an associate and how does equity accounting work? We began this article with consideration of how to identify a subsidiary, and we conclude it with consideration of a relationship between a parent and an associate.

The Paper FA syllabus is limited to the definition and identification of an Associate and describing the principle of equity accounting only.

An associate is defined by IAS 28, *Investments in Associates and Joint Ventures* as 'an entity over which the investor has significant influence'.

Significant influence is the power to participate in the financial and operating policy decisions of the investee but is not control or joint control over those policies.

IAS 28 also states that a holding of 20% or more of the ordinary (voting) shares can be presumed to give the investor significant influence unless it can be demonstrated otherwise. You should use the range 20-50% of voting shares in the exam as your main indicator of significant influence. However make sure you read any other information with regards power to participate or other shareholdings (see illustration 6).

Conversely, significant influence can still be demonstrated where less than 20% of the voting rights are obtained, usually evidenced by:

- representation on the board of directors of the investee
- participation in the policy-making process
- material transactions between the investor and investee
- interchange of management personnel
- provision of essential technical information.

Once we have identified an associate exists, we do not consolidate line by line like we do for a subsidiary. This is simply because we do not have control. Equity accounting is not the same process as consolidation.

For an associate we have to use the equity method, which means we simply bring in our share of the associate's results. In the consolidated statement of profit or loss, any dividend income received from the associate is replaced by bringing in one line that shows the parent's share of the associate's profit. This is presented as 'Share of profits of Associate' as a new heading immediately before the consolidated profit before tax.

In the consolidated statement of financial position, the investment in the associate is shown as a single figure in non-current assets. It is calculated as the cost of the investment + parents share of post-acquisition retained profits (ie the profits the associate has earned since the parent has had significant influence).

Illustration (6) Which of the following investments owned by Indigo Co should be accounted for using the equity method in the consolidated financial statements?

- 30% of the non-voting preference share capital in Yellow Co
- 18% of the ordinary share capital in Blue Co with directors of Indigo Co having two of the five places on the board of Blue Co
- 45% of the ordinary share capital of Red Co, with directors of Indigo Co having four of the six places on the board of Red Co

A 1 and 2 **B** 2 only **C** 1 and 3 only **D** 2 and 3 only

Answer Statement (1): Although a 30% holding appears to fall within the 20–50% range, it is a 30% holding in non-voting preference share capital. These do *not* give Indigo Co significant influence over Yellow Co and, therefore, Yellow Co is *not* an associate and would not be equity accounted.

Statement (2): Despite only 18% of the ordinary share capital being held by Indigo Co, as we have already discussed, we do not just consider the percentage of equity shares held, but also look at whether there can be an exercise of significant influence. Having two out of the five directors effectively gives Indigo Co influence, but not control, over decision making in the company and, therefore, Blue Co is an associate and would be equity accounted.

Statement (3): Don't just look at the 45% holding and presume it is an associate without considering the other facts. By looking at the ability to appoint directors shows that Indigo Co has four of the six directors, effectively giving them power and therefore control over the decision making in the company. Having power and control should make you spot that actually Red Co is a subsidiary and, therefore, would be consolidated line by line in the group accounts and would not be equity accounted.

Therefore, the correct answer is B – Statement 2 only.

(6) Concluding exam tips Remember that at Paper FA, a good solid platform of understanding the principles of consolidation is required.

This is because, although we have used OTs to demonstrate how the consolidation principles could be examined, they could also be assessed using the MTQs in part B of the exam. Typically this will involve calculating the figures for a consolidated statement of profit or loss or a consolidated statement of financial position. You should ensure you have looked at the specimen paper (the full exam amd the additional MTQs) for practice of the fuller consolidation exam questions. You learning providers question banks and revision material will also provide further practice.

Practising full length consolidation questions will help you grasp a better understanding of consolidation. It is important to understand how each calculation fits into the consolidated financial statements, and this will also benefit your future studies when you revisit consolidation in your later Paper Fr and Paper SBR studies.

When answering OTs and MTQs, remember to:

- read the questions requirement carefully and understand what is being asked for
- think about relevant consolidation workings or extracts that may help you
- calculate what you think the correct figure is before you look at OT answer options – be careful not to let the distracters catch you out, so think carefully about your calculation
- re-read the question to ensure you understand it and check you are answering the question set if your initial calculation does not match any of the answer options.

Questions

Salt owns 100% of Pepper. During the year Salt sold goods to Pepper for a sales price of $1,044,000, generating a margin of 25%. 40% of these goods had been sold on by Pepper to external parties at the end of the reporting period. What adjustment for unrealised profit should be made in Salt's consolidated financial statements?

A $83,520
B $104,400
C $125,280
D $156,600

Answer: D

	$000	%
Sales value	1,044	100
Cost of sales	783	75
Profit	261	25

$261,000 x (1 – 40%) = $156,600 unrealised profit

Chapter 6 Preparing a group statement of financial position

Executive Summary

This article shares about how to prepare group statement of financial position.

The objective of the exercise is to prepare the group statement of financial position as if the group were a single entity, it is necessary to

- eliminate the balances on any intra-group current accounts
- recognise any fair value adjustments (FV)

The equity section of the group statement of financial position will contain the share capital and share premium of the parent only.

Retained earnings will include the parents retained earnings and the groups share of the post-acquisition profits of the subsidiary.

A question is gone through to show the steps about how to find Non-Controlling Interests (NCI), goodwill and retained earnings.

This brief article looks at how to prepare a group statement of financial position

Assets and liabilities

When preparing a group statement of financial position the assets and liabilities of the parent and the subsidiary are subject to consolidation adjustments and then added together. For example, as the objective of the exercise is to prepare the group statement of financial position as if the group were a single entity, it is necessary to eliminate the balances on any intra-group current accounts as the group should only be reporting assets and liabilities external to the group. In addition it is also necessary to recognise any fair value adjustments (FV) that will have arisen on the subsidiary's net assets at the date on acquisition and to replace the parent's investment in the subsidiary with the goodwill arising on consolidation.

Equity

In the FA exam, the equity section of the group statement of financial position will contain the share capital and share premium of the parent only. It may also be necessary to ascertain the correct balance on the retained earnings. This will include the parents retained earnings and the groups share of the post-acquisition profits of the subsidiary. The post-acquisition profits of the subsidiary will be shared between the parent (in the group retained earnings) and non-controlling interest (NCI) in the proportion that they share profits and losses.

The following example explains the whole process by taking you through an exercise where all of these issues feature.

Question Two years ago Singapore paid $90,000 for a controlling interest of 80% in the Marina Bay's equity when the retained earnings were $25,000. The summarised statement of financial positions at the reporting date are as follows:

	Singapore $	Marina Bay $
Investment in Marina Bay	90,000	
Property plant & equipment	30,000	30,000

	Singapore $	Marina Bay $
Current assets	30,000	30,000
	150,000	60,000
Equity shares	25,000	15,000
Retained earnings	100,000	40,000
	125,000	55,000
Liabilities	25,000	5,000
	150,000	60,000

Additional information (i). At the date of acquisition the fair value of the NCI of Marina Bay was measured at $20,000 **(ii)**. For consolidation purposes at the date of acquisition the fair value of the non-depreciable land of Marina Bay exceeded its carrying value by $25,000. Marina Bay has not incorporated this fair value adjustments into its individual financial statements. **(iii)**. At the reporting date Singapore is owed $5,000 by Marina Bay.

Required – Prepare the Singapore group statement of financial position.

Answer In approaching such a question there are regular workings that have to be processed. It is necessary to establish the post-acquisition profits of the subsidiary (which are then split between the group and the NCI), the goodwill arising on acquisition as well as the closing balances of the NCI and group retained earnings. It is a good habit to first prepare a working showing the group structure to ensure that we have noted the parent's and the NCI's interest in the subsidiary's profits and how long the subsidiary has been a member of the group.

W1 Group structure

	Singapore (the parent)	
Two years ago	↓	80% / 20% NCI
	Marina Bay (the subsidiary)	

In the next working the fair value of the net assets of the subsidiary at the date of acquisition are established by taking into account the fair value adjustment on the land. The post-acquisition profits of the subsidiary are also determined and split between parent and the NCI in the proportion of their shareholdings. The net assets of the subsidiary are represented by its equity (share capital plus all reserves). Note that the subsidiary's net assets at the date of acquisition need a fair value adjustment on its PPE. This adjustment is still necessary at the reporting date as the asset is still held.

W2 Net assets of the subsidiary

	At acquisition $	At reporting date $	Post-acquisition $
Equity shares	15,000	15,000	
Retained earnings	25,000	40,000	15,000
Book value of the net assets	40,000	55,000	
Fair value adjustment on PPE	25,000	25,000	
Fair value of the net assets	65,000	70,000	-

From this we can see the subsidiary's post-acquisition profits are $15,000. These belong to, and so are allocated, 80% to the group's retained earnings and 20% to the NCI. Further we can note that the net assets of the subsidiary at acquisition is $65,000. This is a key figure for the calculation of goodwill which is our next working. In some questions the fair value of the net assets at acquisition might be given (in this case $65,000) and, so, the FV on the land ($25,000) is ascertained as a balancing figure in the net assets at acquisition column.

Now the goodwill (the premium arising on consolidation) can be ascertained by comparing the value of the whole business as represented by what the parent paid for its controlling interest combined with the NCI, set against the fair value of the identifiable net assets of the subsidiary.

W3 Goodwill

	$
FV of Parent's investment at acquisition – the controlling interest	90,000
NCI @ FV at acquisition – the non-controlling interest	20,000
FV of Net assets at acquisition (w2)	(65,000)
Goodwill arising on consolidation	45,000

The next working is to determine the NCI at the reporting date. This is done by taking account of the entries that we have already seen above. NCI is part of equity (the ownership) of the group and so the opening balance at the date of acquisition will increase with its share of any profits and decrease with any share of losses.

W4 NCI

	$
Opening balance w3	20,000
Plus NCI% of post-acquisition profit (20% x 15,000) w2	3,000
	23,000

Our final working is the retained earnings of the group which comprises the parent's retained earnings plus its share of the subsidiary's post-acquisition profits and losses from the above workings.

W5 Group retained earnings (RE)

	$
Parent	100,000
Plus the % of post-acquisition profit (80% x 15,000) w2	12,000
	112,000

Finally the group statement of financial position can be prepared. The parent's investment in the subsidiary is eliminated as an intra-group item and is replaced with the goodwill. The assets and liabilities are then added together in full, as despite the parent only owning 80% of the shares of the subsidiary, the subsidiary is fully controlled. The non-controlling interest in the subsidiary's net assets is separately reported. There is a consolidation adjustment in respect of the fair value adjustment on the PPE.

Because at the reporting date Singapore is owed $5,000 by Marina Bay this is an intra-group item and this receivable is eliminated from the group accounts as a consolidation adjustment. It also means that Marina Bay will have a payable to Singapore of the same amount which will also be eliminated as a consolidation adjustment.

Singapore group statement of financial position

		$
Goodwill	w3	45,000
Property plant & equipment	(30,000 + 30,000 + fair value adjustment 25,000)	85,000
Current assets	(30,000 + 30,000 less 5,000 inter-company)	55,000
		185,000

		$
Equity shares	(Parent only)	25,000
Retained earnings	w5	112,000
NCI	w4	23,000
Equity		160,000
Liabilities	(25,000 + 5,000 less 5,000 intra-group)	25,000
		185,000

Note where the NCI is presented – it is part of equity and should never be presented in liabilities.

Questions

Which of the following statements apply when producing a consolidated statement of financial position?
(1) All intra-group balances should be eliminated
(2) Intra-group profit in year-end inventory should be eliminated
(3) Closing inventory held by subsidiaries needs to be included at fair value
A 1 only
B 1 and 2
C 2 and 3
D 3 only

Answer: B
There is no requirement to value assets at fair value.