Answers

1 (a) Zippy

Consolidated statement of profit or loss and other comprehensive income for the year ended 30 June 2016

	$m
Revenue	615·6
Cost of sales	(435)
Gross profit	180·6
Investment income	46·1
Administrative costs	(60·2)
Other expenses	(61·3)
Operating profit	105·2
Net finance costs	(16·9)
Group loss on disposal	(8)
Share of profits of associate	3·2
Profit before tax	83·5
Income tax expense	(32·3)
Profit for the year	51·2
Other comprehensive income	
Items that will not be reclassified to profit or loss	
Gains on property revaluation	28·4
Remeasurement component of pension scheme	4
Share of other comprehensive income of associate	1·6
Other comprehensive income for the year	34
Total comprehensive income for year	85·2
Profit attributable to:	
Owners of the parent	45·6
Non-controlling interest (W10)	5·6
	51·2
Total comprehensive income for year attributable to:	
Owners of the parent	74·8
Non-controlling interest (W10)	10·4
	85·2

Working 1

	Zippy $m	Ginny $m	Boo $m	Total $m
Revenue	420	99	90	615·6
Sale of Whizoo (W9)	6·6			
Cost of sales	(304)	(57)	(72)	(435)
Depreciation on fair value uplift (W5)			(2)	
Gross profit	122·6	42	16	180·6
Investment income (W3)	42	14·3	5	46·1
Removal of profit on disposal (W3)	(14)			
Loss on investment property (W7)	(6)			
Investment property gain (W6)	4·8			
Administrative costs	(22)	(9)	(18)	(60·2)
Service cost component (W8)	(10)			
Depreciation adjustment (W6)	(1·2)			
Other expenses	(34)	(13·5)	(15)	(61·3)
Goodwill impairment – Boo (W5)			(1·8)	
Reversal of provision for repairs (W7)	3			
Operating profit	85·2	33·8	(13·8)	105·2
Net finance costs	(2)	(4·5)	(9)	(16·9)
Interest on pension scheme (W8)	(1·4)			
Group loss on disposal (W3)	(8)			(8)
Share of profits of associate (W4)	3·2			3·2
Profit before tax	77	29·3	(22·8)	83·5
Income tax expense	(30)	(5·3)	3	(32·3)
Profit/(loss) for the year	47	24	(19·8)	51·2
Other comprehensive income				
Items that will not be reclassified to profit or loss				
Gains on property revaluation	14	12		28·4
Unrecorded gain on property	2·4			
Remeasurement component of pension scheme (W8)	4			4
Share other comprehensive income of associate (W4)	1·6			1·6
Other comprehensive income for the year	22	12		34
Total comprehensive income for year	69	36	(19·8)	85·2

Working 2 Goodwill – Ginny

	$m	$m
Fair value of consideration for 60% interest	90	
Fair value of non-controlling interest	50	140
Fair value of identifiable net assets acquired		(114)
Goodwill (W3)		26

Working 3 Ginny – disposal

The disposal of 20% will leave Zippy with only a 40% interest and control is lost. The individual profit on disposal will be replaced with the group profit or loss on disposal. Thus $14m is removed from investment income. Only 9/12 of Ginny's profits and other comprehensive income will be consolidated.

Tutorial note: *The $14m gain as stated in the question would have been calculated as: ($44m – (20/60 of $90m)).*

Ginny's profit and other comprehensive income for the nine months to 31 March 2016 is therefore:

	$m
Profit (9/12 x $32m)	24
Other comprehensive income to 31 March 2016 ($16m x 9/12)	12
Total comprehensive income to 31 March 2016	36

Net assets at disposal

	$m
Net assets at 1 July 2015 – per question	118
Total comprehensive income to 31 March 2016	36
	154

Non-controlling interest at disposal

	$m
Non-controlling interest at acquisition	50
Share of post-acquisition gains (40% x ($154m – $114m))	16
	66

Group loss on disposal

	$	$
Proceeds		44
Fair value of remaining interest		62
		106
Goodwill (W2)	26	
Net assets at disposal	154	
Non-controlling interest at disposal	(66)	(114)
		(8)

Working 4 Ginny – associate

As Zippy only owns 40% of the equity of Ginny following disposal, Ginny will be equity accounted for the remaining three months of the year:

	$m
Share profits of associate (40% x 3/12 x $32m)	3·2
Share of other comprehensive income of associate ($16m x 3/12 x 40%)	1·6

Working 5 Boo

Goodwill was initially calculated as $28m. This means that the carrying value of the net assets at acquisition must have been:

	$m
Fair value of consideration of 80% interest	60
Fair value of non-controlling interest	12
Less goodwill	(28)
Carrying value of net assets at acquisition	44

The fair value of the net assets was finalised as $54m, so there is a fair value adjustment to plant of ($54m – $44m) $10m. Additional depreciation should be charged to cost of sales of ($10m/5) $2m (W1). Note the fair values were finalised within the initial accounting period (a maximum of 12 months from acquisition) so the adjustment is treated retrospectively. Goodwill will be adjusted to ($28m – $10m) $18m. Goodwill has been impaired by 10% so ($18m x 10%) $1·8m to be charged to other expenses (W1).

Working 6 Zippy investment properties

The first two floors of Zippy's office block should be classified as property, plant and equipment in the consolidated accounts. Owner occupied property cannot be classified as investment property. The second floor is let to Boo, a subsidiary, and is therefore owner occupied from a consolidated accounts perspective. Depreciation should therefore be charged to administrative costs of $1·2 million (($90m x 0·2)/15). A revaluation gain should be recorded within other comprehensive income of $2·4 million (($96m x 0·2) – (($90m x 0·2)) – $1·2m)). The fair value gain relating to the remaining eight floors should be recorded in profit or loss as this would be classified as investment property. A fair value gain to be included in investment income of $4·8 million (($96m x 0·8) – ($90m x 0·8)) arises.

Working 7 Investment property impairment

Investment properties under the fair value model are restated to fair value with the gains and losses recorded in profit or loss. A ($20m – $14m) $6m loss should therefore be charged to investment income (W1). The provision of $3m should be reversed as there is no obligating event to carry out the repairs (W1).

Working 8 Pension scheme

The service cost component of $10m should be expensed to either administrative expenses or other expenses (W1).

The contributions into the scheme should be ignored as they are correctly added to the pension scheme's assets.

A finance charge should be calculated using the discount rate at 1 July 2015. A charge of (10% x $14m) $1·4m should be included in net finance costs (W1).

The remeasurement gain of $4m should be included within other comprehensive income – items that will not be reclassified to profit or loss (W1).

Working 9 Revenue

The $40 credit per unit is a revision to the transaction price for the first 6,000 units sold. Therefore there should be a reduction in revenue equal to ($40 x 6,000) $0·24m for the first 6,000 units sold. The negotiated price of $950 per unit is dependent on the purchase of the initial 10,000 units. Therefore it does not meet the conditions to be accounted for as a separate contract. Instead it is treated as a cancellation of the old contract together with the creation of a new contract. The revenue attributable to the further 7,000 units manufactured will therefore be calculated using a weighted average price of ((4,000 x $1,000) + (5,000 x $950)/(4,000 + 5,000)) $972 per item. The revenue to be included for these 7,000 units is ($972 x 7,000) $6·8m.

No revenue can yet be included for the 2,000 units which have not been manufactured as at 30 June 2016 as Zippy has not satisfied its performance obligation. The net increase to the revenue of Zippy should be ($6·8m – $0·24m) $6·6 million (W1).

Working 10 Non-controlling interest

	$m
Share of profit:	
Ginny ($24 x 40%) (W1)	9·6
Boo (–$19·8 x 20%) (W1)	(4)
	5·6
Share of total comprehensive income:	
Ginny ($36 x 40%) (W1)	14·4
Boo (–$19·8 x 20%) (W1)	(4)
	10·4

(b) Profit or loss includes all items of income and expense (including reclassification adjustments) except those items of income and expense which are recognised in other comprehensive income (OCI) as required or permitted by IFRS. However, there is a general lack of agreement about which items should be presented in profit or loss and in OCI. Currently under IFRS there is a rules – based approach, leaving it to each individual standard to define where each gain or loss should be presented. For example, with pension schemes the service cost component, including past service cost, must be immediately recognised in profit or loss whereas the remeasurement component is recognised as other comprehensive income, an item not to be reclassified to the profit or loss. With no clear guiding principles of where gains and losses are reported, it is felt that anything controversial has been dumped into OCI. This would enable key ratios such as price/earnings to be free from distortion from less reliable gains and losses included within OCI.

There are several arguments for and against reclassification of gains and losses. If reclassification ceased, there would be no need to define profit or loss and presentation decisions could be left to each individual IFRS. It is argued that reclassification protects the integrity of profit or loss and provides users with relevant information. Errors within actuarial assumptions about life expectancy, wage inflation, service lives as well as differences between actual and expected returns are all included within the remeasurement component. It can be argued that there is no correlation between such items and the underlying performance of an entity. It could therefore be justified to classify the remeasurement component as an item which must not be recycled to profit or loss.

Arguments against recycling include that it adds unnecessary complexity to financial reporting and could lead to earnings management. Recycling could be easily misunderstood as essentially the same gain gets reported twice, once within equity and once within profit or loss. Additionally it is likely that there will be a mismatch on recycling as the gains or losses may be reported in a different period to when the underlying change in value of the asset or liability took place. The IASB is proposing that profit or loss should provide the primary source of information on the return of the entity. Other comprehensive income should be used only if it makes profit or loss more meaningful for the users.

Actuarial gains and losses can vary significantly from one year to the next. The immediate recognition may create volatility within the statement of financial position and other comprehensive income. It is, however, important that users are fully aware as to the extent of an entity's pension scheme obligations. This may not be evident if there is a deferral of the remeasurement component. It will not be possible to smooth gains and losses over the working lives of employees. It can be argued therefore that the immediate recognition leads to greater transparency of the financial statements.

(c) IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* only permits a change in accounting policy if the change is: (a) required by an IFRS or (b) results in the financial statements providing reliable and more relevant information about the effects of transactions, other events or conditions on the entity's financial position, financial performance or cash flows. A retrospective adjustment is required unless the change arises from a new accounting policy with transitional arrangements to account for the change. It is possible to depart from the requirements of IFRS but only in the extremely rare circumstances where compliance would be so misleading that it would conflict with the overall objectives of the financial statements. Practically this override is rarely, if ever, invoked.

IAS 19 *Employee Benefits* requires all gains and losses on a defined benefit scheme to be recognised in profit or loss except for the remeasurement component which must be recognised in other comprehensive income. The directors' proposals cannot be justified on the grounds of fair presentation. The directors have an ethical responsibility to produce financial statements which are a true representation of the entity's performance and comply with all accounting standards.

There is a clear self-interest threat arising from the bonus scheme. The directors' change in policy appears to be motivated by an intention to overstate operating profit to maximise their bonus potential. The amendment to the pension scheme is a past service cost. This is likely to be fairly substantial and must be expensed to profit or loss. This would therefore be detrimental to the operating profits of Zippy and depress any potential bonus. Additionally, it appears that the directors wish to manipulate other aspects of the pension scheme such as the current service cost and, since the scheme is in deficit, the net finance cost. The directors are deliberately manipulating the presentation of these items by recording them in equity rather than in profit or loss. Such treatment is against the ACCA ethical principles of objectivity, integrity and professional behaviour. The directors should be reminded of their ethical responsibilities and must be dissuaded from implementing the proposed change in policy.

2 **(a)** IAS 21 *The Effects of Changes on Foreign Exchange Rates* states that the functional currency is the currency of the primary economic environment in which the entity operates, which is normally the one in which it primarily generates and expends cash. An entity's management should consider the following factors (primary indicators) in determining its functional currency:

– the currency which mainly influences sales prices for goods and services;
– the currency of the country whose competitive forces and regulations mainly determine the sales prices of goods and services; and
– the currency which mainly influences labour, material and other costs of providing goods and services.

Further factors (secondary indicators), which may also provide evidence of an entity's functional currency, are the currency in which funds from financing activities are generated and in which receipts from operating activities are retained. Other factors include the autonomy of a foreign operation from the reporting entity, the level of transactions between the entities, whether the foreign operation generates sufficient cash flows to meet its debt obligations, and whether its cash flows directly affect those of the reporting entity.

Suntory
It appears that the dollar is the functional currency of Suntory. Suntory's sales prices are determined by legal requirements and the business environment in its own jurisdiction and the dollar is the currency in which the sales prices are denominated and settled. The operations are sourced locally in dollars. There is a small amount of trading in other currencies and Minor pays a dividend on a monthly basis in euros but the main currency of its operations is the dollar, which indicates that the dollar is the functional currency of the parent. Suntory need not consider the secondary factors.

Maior
The factors in the scenario seem to indicate the yen as being the functional currency of Maior. The sales prices for the subsidiary's golf equipment are determined by local legal and business conditions in yen. The yen is the currency in which those sales prices are denominated and settled. Some transactions are undertaken with China but these are relatively small. Although Maior sometimes imports and sells its parent's products, this is only a small part of its business activity. The yen is also used to pay the major operating costs. Thus without evidence to the contrary, the yen is the functional currency of Maior and Maior need not consider the secondary factors.

Minor
Minor imports golf clothing manufactured by Suntory and pays the parent in dollars. Suntory discounts the price paid by Minor for its products, which are sold in euros.

The prices are influenced both by the local legal and business conditions and the cost of the product purchased from Suntory. Also all price changes have to be approved by Suntory. Thus the exchange rate between the dollar and the euro will affect the pricing of the product. All other operating expenses are incurred locally and paid in euros. A dividend amounting to the net profit for the month is paid in euros to Suntory. The determination of the functional currency is not clear-cut.

The euro is the currency in which Minor's sales prices are set, denominated and settled. However, movements in the exchange rate between the euro and the dollar influence those selling prices. Minor's sales prices are also affected by the local legal and business conditions in Portugal. The costs of the products from Suntory are influenced by the dollar but all other costs of providing goods are in euros. As a result, the secondary factors should be considered.

Funds from financing activities are generated primarily in dollars and Minor keeps minimal cash reserves because any net profit is transferred to the parent in cash at the end of the month. Consequently, there is some support for the dollar as being the functional currency as Minor is not autonomous, transactions with the parent are a high proportion of the subsidiary's activities as Suntory is the subsidiary's only supplier and cash flows from the activities of Minor directly affect the cash flows of Suntory and are readily available for remittance to it. Thus it appears that the dollar is the functional currency of Minor.

(b) IAS 38 *Intangible Assets* states that the cost less residual value of an intangible asset with a finite useful life should be amortised on a systematic basis over that life, that the amortisation method should reflect the pattern of benefits and that it should be reviewed at least annually.

The amortisation method should be reviewed at least annually and, if the pattern of consumption of benefits has changed, the amortisation method should be changed prospectively as a change in estimate under IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. Expected future reductions in sales could be indicative of a higher rate of consumption of the future economic benefits embodied in an asset. Hence, the trademark would be amortised over a 2·5-year period until May 2018.

IAS 36 states that an entity should assess at the end of each reporting period whether there is any indication that an asset may be impaired. If any such indication exists, the entity should estimate the recoverable amount of the asset. Irrespective of whether there is any indication of impairment, an entity shall also test an intangible asset with an indefinite useful life or an intangible asset not yet available for use for impairment annually by comparing its carrying amount with its recoverable amount. This impairment test may be performed at any time during an annual period, provided it is performed at the same time every year. Thus, Suntory should test the trademark for impairment.

For the year ended 30 November 2016

Dr Profit or loss (operating expenses) – amortisation of trademark	$840,000
Cr Intangible asset (trademark) – accumulated amortisation	$840,000

To recognise the annual amortisation of the trademark during the period.

At 30 November 2016

Dr Profit or loss (operating expenses) – impairment of trademark	$760,000
Cr Intangible asset (finite life trademark) – impairment	$760,000

To recognise the impairment loss for the trademark.

Workings

Cost of trademark $3m ÷ 10 years useful life = $300,000 amortisation per year. Therefore the carrying amount at 1 December 2015 is ($3m cost less ($300,000 amortisation per year x 3 years since acquisition)) = $2·1m.

The useful life of the trademark is reduced to 2·5 years and therefore this amount has to be amortised over this period.

$2·1 m ÷ 2·5 years remaining useful life = $840,000 per year

Therefore the carrying amount at 30 November 2016 is $3m cost less $900,000 less $840,000 = $1·26 million.

The recoverable amount is $500,000, so the impairment loss is $760,000.

(c) IAS 24 *Related Party Disclosures* requires an entity's financial statements to contain the disclosures necessary to draw attention to the possibility that its financial position and profit or loss may have been affected by the existence of related parties and by transactions and outstanding balances with such parties.

A person or a close member of that person's family is related to a reporting entity if that person:

(i) has control or joint control over the reporting entity;
(ii) has significant influence over the reporting entity; or
(iii) is a member of the key management personnel of the reporting entity or of a parent of the reporting entity.

With regards to Suntory, the finance director is a related party, as he owns more than half of the voting power (60%). In the absence of evidence to the contrary, he controls Suntory and is a member of the key management personnel. The sales director is also a related party of Suntory as she is a member of the key management personnel and is a close member (spouse) of the family of the finance director. Their son is a related party of Suntory as he is a close member (son) of their family. The operations director is also a related party as he owns more than 20% of the voting power in Suntory. In the absence of evidence to the contrary, the operations director has significant influence over Suntory and is a member of the key management personnel.

An entity is related to a reporting entity if the entity is controlled or jointly controlled by a person identified as a related party. Hence, Baleel is a related party of Suntory. Baleel is controlled by related parties, the finance and sales directors, for the benefit of a close member of their family, i.e. their son.

In the absence of evidence to the contrary, the third owner of the shares is not a related party. The person is a passive investor who does not appear to exert significant influence over Suntory. The loan from the bank, which has been guaranteed by the finance director, will be disclosed as such in the financial statements. Disclosure of personal guarantees given by directors in respect of borrowings by the reporting entity should be disclosed in the notes to the financial statements.

3 (a) A financial liability for the present value of the maximum amount payable to shareholders should be recognised in the financial statements as of 31 August 2016. At 31 August 2016, the rights are equivalent to a written put option because they represent for Evolve a purchase obligation which gives shareholders the right to sell the entity's own equity instruments for a fixed price. The fundamental principle of IAS 32 *Financial Instruments: Presentation* is that a financial instrument should be classified as either a financial liability or an equity instrument according to the substance of the contract, not its legal form, and the definitions of financial liability and equity instrument. IAS 32 states that a contract which contains an entity's obligation to purchase its own equity instruments gives rise to a financial liability, which should be recognised at the present value of its redemption amount. IAS 32 also states that a contractual obligation for an entity to purchase its own equity instruments gives rise to a financial liability for the present value of the redemption amount even if the obligation is conditional on the counterparty exercising a right to redeem, as is the case with the scrip issue of Evolve.

Evolve had set up the conditions for the share capital increase in August 2016 and, therefore, the contract gave rise to financial liabilities from that date and Evolve should have recognised a financial liability for the present value of the maximum amount payable to shareholders in its financial statements for the year ended 31 August 2016. A non-adjusting event under IAS 10 *Events after the Reporting Period* is an event after the reporting period which is indicative of a condition which arose after the end of the reporting period. However, it could be argued that the transferring of the free allocation rights back to Evolve is in fact an adjusting event as it is an event after the reporting period which provides further evidence of conditions which existed at the end of the reporting period.

(b) The non-current assets of Resource should have been presented as held for sale in the financial statements, in accordance with IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*, as at 31 August 2016. IFRS 5 states that the appropriate level of management must be committed to a plan to sell the asset for the sale to be probable. Evolve's acceptance of a binding offer in August 2016 and the publication of this information indicated a high probability of sale. Despite the uncertainties surrounding the sale, the transaction remained highly probable at 31 August 2016. IFRS 5 requires an entity to classify a non-current asset as held for sale if its carrying amount will be recovered principally through sale rather than through continuing use.

IFRS 5 does not require the existence of a binding sales agreement in order to classify a non-current asset as held for sale but only a high probability of its occurrence. The acceptance of an offer by Evolve indicates that the transaction met the criteria to be classified as held for sale at 31 August 2016. The finalisation of the agreement on 20 September 2016 only confirmed the situation existing at 31 August 2016. Further, Evolve cannot apply IFRS 5 measurement criteria without classifying the item as held for sale in its statement of financial position particularly as a profit or impairment may arise when using such criteria. IFRS 5 also states that immediately before the initial classification of the asset as held for sale, the carrying amount of the asset should be measured in accordance with applicable IFRSs. This was already the case as regards the non-current assets of Resource.

Other criteria which indicate that the non-current assets should be shown as held for sale include the fact that a buyer for the non-current assets has been found, the sale occurred within 12 months of classification as held for sale, the asset was actively marketed for sale at a sales price which has been accepted, and despite the uncertainties at 31 August 2016, events after the reporting period indicate that the contract was not significantly changed or withdrawn. The fact that the information regarding the uncertainties was not publicly disclosed is irrelevant.

Thus as the non-current assets met the criteria to be classified as held for sale, they should have been measured and presented as such in the financial statements. Assets classified as held for sale must be presented separately on the face of the statement of financial position.

(c) IFRS 3 *Business Combinations* must be applied when accounting for business combinations, but does not apply where the acquisition is not of a business. In this case, the acquisition was essentially that of an asset and therefore the measurement requirements of IFRS 3 would not apply.

IAS 40 *Investment Property* states that the cost of an investment property comprises its purchase price and any directly attributable expenditure, such as professional fees for legal services. IAS 16 *Property, Plant and Equipment* states that the cost of an item of PPE comprises any cost directly attributable to bringing the asset to the condition necessary for it to be capable of operating in the manner intended by management. Hence if Evolve wishes to use the cost basis for accounting for the investment property, the potential gain should not have been recorded in profit or loss or added to the cost of the asset.

Evolve should have recognised the tax payment as an expense in the statement of profit or loss and other comprehensive income. Administrative and other general overhead costs are not costs of an item of PPE according to IAS 16. The specific fiscal treatment and the tax to be paid were not linked to bringing the asset to the condition necessary for its operations, as the asset would have been operational without the tax. As such, the tax is a cost linked to the activity of Evolve and should be accounted for as an expense in accordance with IAS 12 *Income Taxes* and included in the profit or loss for the period, unless that tax arises from a transaction recognised outside profit or loss.

4 (a) (i) Information is material if omitting it or misstating it could influence decisions which users make on the basis of financial information about a specific reporting entity. Materiality is an entity-specific aspect of relevance, based on the nature and/or magnitude of the items to which it relates in the context of the entity's financial report. It is therefore difficult to specify a uniform quantitative threshold for materiality or predetermine what could be material in a particular situation. Materiality should ensure that relevant information is not omitted or mis-stated and it should help filter out obscure information which is not useful to users of financial statements.

The *Conceptual Framework* describes materiality as an application of relevance by a particular entity. When an entity is assessing materiality, it is assessing whether the information is relevant to the readers of its own financial statements. Information relevant for one entity might not be as relevant for another entity. IAS 1 *Presentation of Financial Statements* says that an entity need not provide a specific disclosure required by an IFRS if the information is not material and that the application of IFRSs, with additional disclosure when necessary, is presumed to result in financial statements which achieve a fair presentation. In other words, material information must be disclosed irrespective of whether there is an explicit disclosure requirement.

Although preparers may understand the concept of materiality, they may be less certain about how it should be applied. Preparers may be reluctant to filter out information which is not relevant to users as auditors and regulators may challenge their reasons for the omissions. The way in which some IFRSs are drafted suggests that their specific requirements override the general statement in IAS 1 that an entity need not provide information which is not material. Standards are often complied with rigidly which leads to 'boiler plate' disclosures. Regulators are not keen to encourage the use of judgement but rather wish compliance with IFRS. If the concept of materiality was applied successfully, then immaterial information would be removed and the performance and the position of the entity would be more visible. Investors require better, more relevant, material information. The time and resources available in a reporting cycle may mean that many preparers are not capable or willing to make a materiality judgement. Regulators are often unwilling to apply a principle-based view, and are often quick to raise a query when a disclosure has been removed or not included.

Accounting policy disclosures often repeat information which was contained in IFRS and are not entity-specific. Information outside of financial statements cannot be policed and often key information is given in corporate presentations or outside the financial statements, which reinforces the perception that financial statements are a compliance document.

(ii) Integrated reporting (IR) takes a broader view of business reporting, emphasising the need for entities to provide information to help investors assess the sustainability of their business model. IR is a process which results in communication, through the integrated report, about value creation over time. An integrated report is a concise communication about how an organisation's strategy, governance, performance and prospects lead to the creation of value over the short, medium and long term. The materiality definition for IR purposes would consider that material matters are those which are of such relevance and importance that they could substantively influence the assessments of the intended report users. In the case of IR, relevant matters are those which affect or have the potential to affect the organisation's ability to create value over time. For financial reporting purposes, the nature or extent of an omission or misstatement in the organisation's financial statements determines relevance. Matters which are considered material for financial reporting purposes, or for other forms of reporting, may also be material for IR purposes if they are of such relevance and importance that they could change the assessments of providers of financial capital with regard to the organisation's ability to create value. Another feature of materiality for IR purposes is that the definition emphasises the involvement of senior management and those charged with governance in the materiality determination process in order for the organisation to determine how best to disclose its value creation development in a meaningful and transparent way.

(iii) IAS 7 *Statement of Cash Flows* was first published in 1992 and has been barely changed since that date. However, there are issues with the current standard. For example, cash flows from the same transaction may be classified differently. A loan repayment would see the interest classified as operating or financing activities, whereas the principal will be classified as a financing activity. The operating activities in the cash flow statement can be presented in one of two ways: the direct method and the indirect method. The direct method is seldom used as it displays major classes of gross cash receipts and payments. Companies' systems often do not collect this type of data in an easily accessible form. The indirect method is more commonly used to present operating activities. The presentation of operating profit under the indirect method of the cash flow statement can start with either profit or loss before or after tax. A user's ability to make comparisons may be affected if entities present reconciliations with different starting points. There are concerns over the current classification of items in the statement of cash flows. For example, dividends and interest paid can be classified as either operating or financing activities. As a result, users have to make appropriate adjustments when comparing different entities, particularly when calculating free cash flow for valuation purposes. Additionally, when a user is assessing an entity's ability to service debt, interest paid would be reclassified from operating activities to financing activities.

Research expenditure is classified as cash from operating activities but is often considered to be a long-term investment. Some argue that such cash outflows should be included within investing activities, because they relate to items, which are intended to generate future income and cash flows. IAS 7 takes the view that, to be classified as an investing cash outflow, the expenditure must result in an asset being recognised in the statement of financial position.

Some items of property, plant and equipment are purchased from suppliers on similar credit terms to those for inventory and for amounts payable to other creditors. As a result, transactions for property, plant and equipment may be incorrectly included within changes in accounts payable for operating items. Consequently, unless payments for property, plant and equipment are separated from other payments related to operating activities, they can be allocated incorrectly to operating activities.

There are currently different views as to how to show lessee cash flows in the statement of cash flows. Some users would like the statement of cash flows to reflect lessee cash outflows in a way which is comparable to those of a financed purchase where the entity buys an asset and separately finances the purchase. Other users take the view that lease cash payments are similar in nature to capital expenditure and should be classified within investing activities in the statement of cash flows. Finally, there is concern about the current lack of comparability under IFRS because of the choice of treatment currently allowed. A lessee can classify interest payments within operating activities or within financing activities.

Partly as a result of the above practices, the IASB has published an Exposure Draft (ED), which proposes amendments to IAS 7. The main objective of the ED is to improve information about changes in an entity's liabilities which relate to financing activities and the availability of cash and cash equivalents including any restrictions on their use. The ED results from the IASB's Disclosure Initiative, which comprises several smaller projects to improve presentation and disclosure requirements in existing IFRSs. The proposed amendments would require an entity to provide a reconciliation of the opening and closing amounts in the statement of financial position for each liability for which cash flows are classified as financing activities. The proposed changes will require companies to reconcile the movement in debt from one period to another and together with the existing information from the statement of cash flows; this will facilitate net debt reconciliation.

Because many entities already voluntarily disclose a net debt reconciliation, the proposed changes should theoretically not impose any additional burden on issuers. The proposed amendments also require issuers to provide information to help users better understand any liquidity issues. The understanding of limitations on the use of liquid resource is important and some users would like additional disclosures to better understand the different types of debt financing by the entity. The changes should help users in making investment decisions.

(b) Notes to the statement of cash flows (direct method and indirect method)

Components of financing activities (excluding equity) $ million

Sanchera, a listed company, has prepared a statement of cash flows for the year ended 31 August 2016. In financing activities, it has shown an increase in long-term borrowings to $140 million and an increase in the capital element of finance lease liabilities to $17 million.

	2015 Cash flow	Non-cash changes	2016 Acquisition	New leases	Total
Long-term borrowings	50	55	35		140
Lease liabilities	5	(3)		15	17
Long-term debt	55	52	35	15	157

Sanchera showed interest paid on lease liabilities of $5 million in operating activities and this would remain there under the proposed exposure draft. Finally, Sanchera had an overdraft with the bank of $2 million and this would be shown in cash and cash equivalents and not in financing activities.

			Marks
1	**(a)**	Revenue	4
		Investment income and properties	3
		Goodwill Ginny	2
		Net assets and NCI at disposal	3
		Ginny disposal	5
		Ginny associate	3
		Boo and impairment	3
		Provision	2
		Pension	3
		Non-controlling interest	4
		Income tax expense	1
		Presentation of OCI into reclassified/not reclassified to profit or loss	1
		Split of profit and OCI between parent and NCI	1
			35
	(b)	1 mark for each point to a maximum of	8
	(c)	1 mark for each point to a maximum of	7
			50
2	**(a)**	1 mark per point up to maximum	9
	(b)	1 mark per point up to maximum	7
	(c)	1 mark per point up to maximum	7
	Professional marks		2
			25
3	**(a)**	1 mark per point up to maximum	8
	(b)	1 mark per point up to maximum	9
	(c)	1 mark per point up to maximum	6
	Professional marks		2
			25
4	**(a)**	**(i)** 1 mark per point up to maximum	7
		(ii) 1 mark per point up to maximum	4
		(iii) 1 mark per point up to maximum	7
		Professional marks	2
	(b)	1 mark per point up to maximum	5
			25