ACA MASTERS

Financial Accounting and Reporting: Learning Materials

These notes summarise the key technical content for the most examinable parts of the syllabus and therefore serve as a useful revision tool. The notes also include calculation proformas and reminders.

The Exam Technique Guidance section provides specific advice as to how to approach the different types of exam question in the FAR exam. Our classroom and online tuition classes demonstrate how to apply these techniques to recent FAR exam questions in order to score prize-winning marks.

Contents:

ASSETS

A resource **controlled** as a result of **past events,** from which it is **probable that economic benefits will flow** to the entity, and the asset can be **measured reliably**

IAS 16 Capitalisation

- Cost includes all 'directly attributable' costs, which includes more than just purchase price – see PPE note below
- Separate components and enabling costs (e.g. inspections) are capitalised and depreciated separately

IAS 23 Borrowing costs

- Interest costs on loans which are directly attributable to the PPE are capitalised as part of the asset - Dr PPE, Cr Cash
- Start capitalising once expenditure on asset is incurred, interest costs have been incurred <u>and</u> asset is being made ready for use
- Cease capitalisation as soon as asset is 'ready for use'

IAS 16 Subsequent measurement

- Cost model: Carrying Amount (CA) = Cost – Depr' / Impairments
- Revaluation model: CA = FV – Depr' / Impairments
- Assets of same class must follow same model i.e. if one building is revalued, all buildings must be revalued
- The revalued gain is 'unrealised' so is recorded in OCI rather than P&L - Dr PPE, Cr OCI
- Going forward, depreciation is charged on the new, higher revalued amount so depreciation in P&L is higher which causes profits (and therefore retained earnings) to be lower
- Therefore, reserve/equity transfers can be made for the 'additional' depreciation - Dr Revaluation Reserve, Cr Retained earnings. These puts retained earnings back to the position they would have been without the revaluation and higher depreciation

IAS 36 Impairment

- Occurs when an asset's recoverable amount (RA) falls below its carrying amount (CA)
- RA amount is higher of: Fair Value (FV) minus selling costs and Value in Use (PV of cash the business will generate from using it)

FINANCIAL INSTRUMENTS, EQUITY, LEASES

Liability v Equity

- Two ways for a company to raise money: debt or equity
- Debt – A contractual obligation to make a payment i.e. lender has right to receive interest and repayment of amount lent to the company
- Equity – A residual interest in the net assets of the entity i.e. investor has a share of the company's net assets

	Debt	**Equity**
Nature	Counterparty has lent money to company	Counterparty has invested money in company
Return	Fixed interest payment	Dividends paid only if company makes a profit
Legal right	Right to receive interest and to have money invested repaid by company	No right to receive dividends or to have money invested repaid by company
Risk	Low risk	High risk
IS	Interest expense	NA
SOCE	NA	Dividends paid
SFP	Liability, as legal obligation to pay interest and repay debt	Equity, as investor only has right to the company's assets once all liabilities are paid
e.g.	Loans, Bonds, Redeemable shares, Shares with fixed dividend	Ordinary shares

Financial Liability: *Obligation to pay cash or financial asset to another party*

- Trade payables
- Loans / Bonds payable
- Preference shares with fixed dividend
- Redeemable preference shares

Measurement

- Initially measured at FV which is calculated using the effective interest rate method (PV of future payments that will be made – see below). This is not always the nominal (par / face) value.

Cr Liability, Dr Cash

- Capitalise any 'transaction costs' e.g. broker fees:

Dr Liability, Cr Cash

- Subsequent measurement is on an 'Amortised cost' basis (below)
- The effective interest rate will ensure that the initial liability recognised is increased up to the actual amount payable at each payment date. This increase in the liability is recorded as a Finance Expense in P&L.

Cr Liability, Dr Interest Expense

- Cash interest paid is not recorded in the P&L as we have already accrued the effective interest:

Dr Liability, Dr Cash

Amortised cost

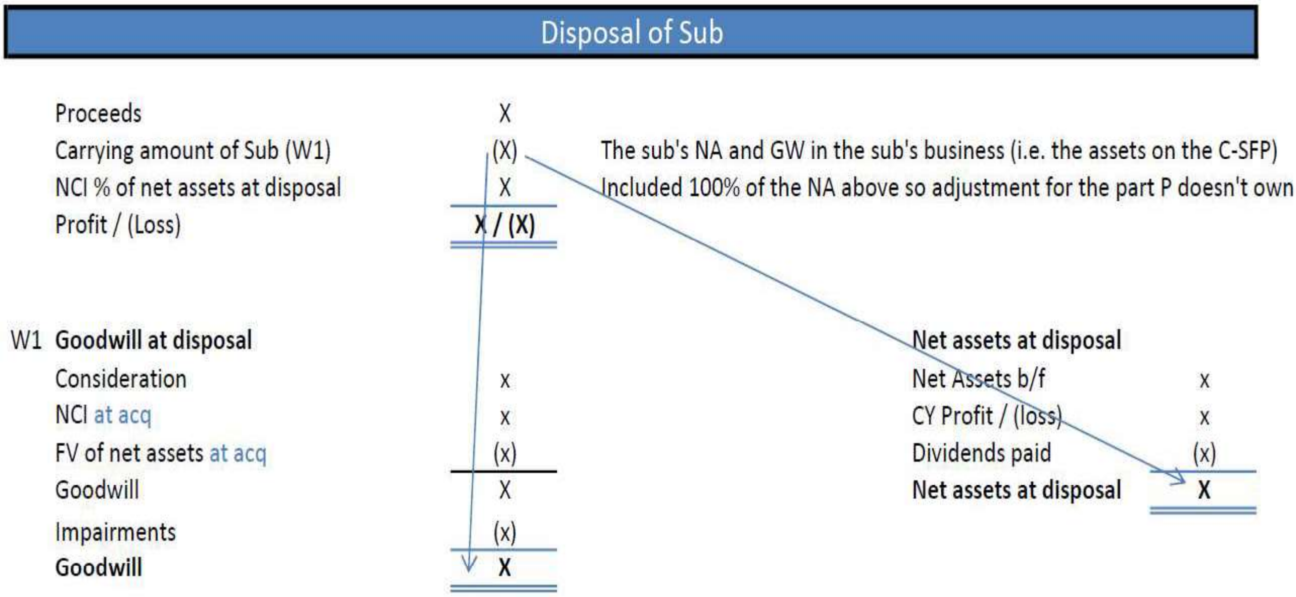
	b/f	Interest	Cash payment	c/f
Yr1	x	x	(x)	x
Yr2	x	x	(x)	x
Yr3	x	x	(x)	x

Fair Value calculation

	Cash payment	Discount factor	PV	
Yr 1	x	x	x	
Yr 2	x	x	x	
			X	b/f in amortised cost table

Disposals

- Similar to any disposal: remove assets being sold from SFP, record cash and any difference is Profit or Loss
- Dr Cash, Cr Net Assets of Sub (including goodwill), Cr Profit on disposal



Disposal of Sub

Proceeds	X	
Carrying amount of Sub (W1)	(X)	The sub's NA and GW in the sub's business (i.e. the assets on the C-SFP)
NCI % of net assets at disposal	X	Included 100% of the NA above so adjustment for the part P doesn't own
Profit / (Loss)	**X / (X)**	

W1	**Goodwill at disposal**	
	Consideration	x
	NCI at acq	x
	FV of net assets at acq	(x)
	Goodwill	X
	Impairments	(x)
	Goodwill	**X**

Net assets at disposal	
Net Assets b/f	x
CY Profit / (loss)	x
Dividends paid	(x)
Net assets at disposal	**X**

C-SFP

- Don't consolidate as S no longer under 'control' of group

C-IS

- Consolidate S's results up to the point of disposal and the profit attributable to NCI
- Disclose S's results + profit on sale as discontinued operations per IFRS5