Dear Sir

Herewith the report on the issues regarding the change in holdings and film production:

ISSUE 1

Part (a)

- The exchange of the 30% stake in Cans (International) Ltd for a 12% stake in Acorn Plc represents a change in the nature of the investment. The investment changes from a local unlisted company to a foreign listed company. It is therefore regarded as an exchange of dissimilar assets.
- Manic Ltd probably had a significant influence over Cans (International) Ltd and accounted for it as an associate in the consolidated financial statements. This investment in an associate should now be derecognised.
- Manic Ltd should recognise the exchange of shares on the date on which it accepted the offer of the exchange and on which the offer became unconditional.
- In its financial statements, Manic Ltd should recognise a profit or loss for the difference between the fair value of the 12% interest received in Acorn Plc and the carrying value of Manic Ltd’s interest in Cans (International) Ltd.
- The fair value of the interest received in Acorn Plc may be established by reference to the quoted price of those shares, which have been listed for some time (AC 133.97).
- The initial carrying value of the investment in Acorn Plc should be its fair value at the date of the exchange of shares (AC 133.67).

Part (b)

- The received interest in Acorn Plc should be classified as either available for sale or held for trading in terms of AC 133.

Part (c)

- The profit/loss realised on the share exchange does not reflect normal trading performance. Rather, it is a profit on disposal of a capital item.
- In accordance with AC 306 the profit or loss on disposal should therefore be excluded from headline earnings.

ISSUE 2

Part (a)

The following pertain to the group and company financial statements of Manic Ltd:

- The films (when acquired) will meet the definition of an asset as it is a resource controlled by the enterprise as a result of past events (the purchase agreement), and from which future economic benefits are expected to flow to the enterprise (licence fees) (AC 000.49(a)).
- The film meets the definition of an intangible asset as per AC 129.08.
- An intangible asset is defined as an identifiable non-monetary asset without physical substance held for use in the production or supply of goods or services, rental to others, or for administrative purposes. The film is an identifiable non-monetary asset without physical substance as the value is in the distribution of the film rather than the “physical reel”. The film will be licensed to a distributor.
- The film should be recognised when purchased as an intangible asset at its cost of £1 million at the spot exchange rate on that date (AC 129.23).
Part 1 – Paper 2
Suggested solution – Question 3

- The film should subsequently be amortised over its expected commercial life of ten years (AC 129.64).
- The asset should be considered for impairment on an annual basis (AC 128) to assess whether the carrying amount is greater than the recoverable amount.
- The recoverable amount is determined based on the higher of the asset’s net selling price or its value in use.
- Films are specifically excluded from the scope of AC 105.
- Manic Ltd should recognise the loan which it has raised as a financial liability of £750 000, because it is an obligation to deliver cash.
- The loan should be remeasured at the end of each period at the closing exchange rate and resultant exchange gains or losses should be recognised in earnings.
- The annual licence fees and the bullet licence fee should be accrued as income over the ten-year licence period on a basis that reflects the expected value of the film (AC 111.33(b)).
- The 60% profit share should be accrued as revenue when the licensee earns profits.
- Manic Ltd should recognise a deferred tax liability in respect of the difference between the cost price of the film (its carrying value) and zero (its tax base after immediate deduction of the cost for tax purposes.)

Part (b)

- There are no specific disclosure requirements for the license fee arrangements. However, disclosure of the arrangements is consistent with the objective of financial statements, namely to enable users to make economic decisions by evaluating “the ability of an enterprise to generate cash and cash equivalents and of the timing and certainty of their generation”.
- Manic Ltd should disclose the significant terms of the license fee arrangements, namely
  - the currency in which payments are denominated,
  - the dates of expected payments,
  - the amounts of expected payments, and
  - the entitlement to profits.
- Manic Ltd should disclose the existence of the guarantee of the bullet licence fee payment.

Yours faithfully

A. Auditor