Q&As

P7 Financial Accounting and Tax Principles

Questions from tutors and the Examiner's answers

Q I have a question regarding accounting for Treasury shares (17.8) and accounting for the repurchase of shares (17.9). According to the manual, treasury shares are those shares that the company has repurchased. They are accounted for as no deduction from the Share Capital line in the Balance Sheet but as Treasury Shares as a separate line and the amount is equal to the full price paid. However, the next section of the manual describes the accounting treatment for the repurchase of shares as a reduction to the Share Capital line in the balance sheet with the creation of the Capital Redemption Reserve - no mention of Treasury shares. At first sight, the two sections in the manual appear to be demonstrating two different treatments for the same transaction. I would greatly appreciate clarification in this matter.

A **"Treasury shares are shares that the entity purchases with the intention of re-issuing at some point in the future. Section 17.8 says that these shares are shown as a deduction from equity. This is also shown in example 17f. Where shares are repurchased and cancelled, for example redeemable shares, the entity reduces equity when the shares are cancelled, this creates the need for a capital redemption reserve unless the purchase is funded from a new issue."**

Q IAS 19 is covered in full in Paper 8. It is not clear to what level it is to be covered in Paper 7. Please advise whether students need to cover the following:

- Both employee benefits and post-employment benefits
- Defined benefit plans
- The projected unit credit method
- The calculation of actuarial gains and losses, including discounting and the use of probabilities
- Curtailments, settlements and termination payments

A **IAS 19 is not in the paper P7 syllabus and will not be examined at all.**

Q Under IAS 17, there is no mention of students being required to have knowledge of substance over form in the syllabus – however this is an underlying principle for accounting for leases. Please advise whether students would be expected to be aware of it when answering questions in IAS 17.

A **The learning outcome says "explain the principles of the accounting rules…" (LO C(v)). Substance over form is an underlying principle of leases, therefore students need to be aware of it.**

Q The CIMA Study System makes no mention of IFRS 5, but refers instead to the superseded IAS 35. How will students be expected to deal with discontinued operations in the exam?

A **IAS 35 was current when the Study System was being developed, so was included. IFRS 5 has replaced IAS 35 and would therefore become the examinable document. The legislation cut-off date for the CIMA syllabus is 1 December prior to the examination concerned (ie 1 December 2004 for 2005 examinations) so it is well within the time period for new standards. As IAS 35 is in the manual it will be accepted in answers as an alternative to IFRS 5 for the 2005 examinations.**

Q In the pilot paper, applicable maths tables and formulae sheets were included with the exam. Please advise whether there is an assumption that students need to be aware of the issues of compounding and discounting from their previous papers and will have to apply the techniques in questions set, or whether it would be a specific area of testing?

A **Students need to be aware of the issues of compounding and discounting and apply the techniques in questions set.**

Q The syllabus doesn't include IAS 33 *Earnings Per Share*, but Question 8 on the pilot paper requires students to do a relatively simple EPS calculation. Should students be able to do this kind of calculation, even though it isn't mentioned on the syllabus?

A **Earnings per share is not in the P7 syllabus and will not be examined, that is why there is no reference to IAS 33; it is on P8 however. The question on the pilot paper did not require an EPS calculation, however the answer erroneously included a simple EPS calculation for which my apologies.**

Q Under IAS 33, please advise whether these aspects are examinable?

- EPS following a bonus issue
- EPS following a rights issue
- Diluted EPS

A **IAS 33 is not in the paper P7 syllabus and will not be examined at all.**

Q I have a query on how pilot paper question 5 (income statement) detailed below has been answered by FTC's textbook (which I use with my students) and CIMA, but I think BPP have answered this question correctly. Can you please confirm this?

Pilot paper question 5
On 1 January 2003, SPJ had an opening debit balance of £5,000 on its tax account, which represented the balance on the account after settling its tax liability for the previous year. SPJ had a credit balance on its deferred tax account of £1.6 million at the same date. SPJ has been advised that it should expect to pay £1 million tax on its trading profits for the year ended 31 December 2003 and increase its deferred tax account balance by £150,000.

Required:
Prepare extracts from the income statement for the year ended 31 December 2003, balance sheet at that date and notes to the accounts showing the tax entries required.

Answer by FTC and CIMA

Tax for current year	1,000,000
Balance brought forward 1 January 2003	(5,000)
Deferred tax increase	150,000
Income statement	1,145,000

Answer by BPP

Income tax for the year	1,000,000
Under provision in previous year	5,000
Increase in deferred tax	150,000
Income statement	1,155,000

A **Both answers are correct, depending on your reading of the question. It depends on whether the debit balance is seen as an over-payment or an under-provision. If the assumption is an over-payment that will be refunded, the CIMA/FTC answer is correct. If the assumption is that there was an under-provision which needs to be corrected in the following year, the BPP answer is correct.**