Comments on the statement of financial position of Aztec (Europe)

√1 The statement of financial position shows that there are continuing problems in that the new company has negative net current assets which make the company unattractive to suppliers. In addition there is very high gearing and there have been no proposals for raising further capital with the result that the company will see its overdraft standing at a higher figure than the closing balance in the old company due to reorganisation costs, and no funds to purchase the new warehouse referred to in the question. √1 √1

ACCA marking scheme		
		Marks
(a)	Closing of Aztec and opening of Aztec (Europe)	10
(b)	Memorandum to finance director	15
Total		**25**

ANSWER 3 – FINANCIAL INSTRUMENTS

(a) IFRS 9 simplifies the classification and accounting treatment of financial assets in comparison with IAS 39. There are now only three classifications of financial assets, whereas previously there were four. Whilst there is increased emphasis upon fair value accounting, IFRS 9 retains a mixed measurement model, with some financial assets measured at amortised cost, provided certain conditions are complied with. √0.5 √0.5

In due course, the content of IFRS 9 will be updated to deal with liabilities (done in November 2010), impairment and hedging. Unless IFRS 9 has been updated to deal with specific issues, the provisions of IAS 39 continue to apply. IFRS 9 is effective for accounting periods commencing on or after 1 January 2013, although earlier adoption is permitted. √0.5

Financial assets that are classified as debt instruments are normally subsequently measured at **fair value through profit or loss** unless they are designated at the date of initial recognition to be classified in any other way. IFRS9 has an increased emphasis upon fair value accounting as a result. This classification will include any financial assets held for trading purposes and the accounting treatment effectively incorporates an annual impairment review as all changes in fair value are taken to income. √1 √1

However debt instruments can be subsequently measured **at amortised cost.** Financial assets can be designated to be measured at amortised cost upon initial recognition. For this to happen, two tests must be passed: √1

- The business model test – what is the underlying business purpose for having the financial asset? Is it to take advantage of movements in fair value or to collect in the cash flows associated with the asset? In the former case, the test is failed, whereas in the latter case, the test is passed. √1.5
- The contractual cash flows characteristics test – do the cash flows associated with the financial asset consist ***solely*** of repayments of interest and capital? If the answer is yes, the test is passed; if no, the test is failed. √1.5

Where either or both tests are failed, the financial asset must be measured at fair value through profit or loss. This would apply to the holder of convertible debt, as the cashflows are affected by the fact that, upon maturity date, there is a choice to be made between taking cash and converting the convertible debt into equity shares. √1 √0.5