IRELAND

CORPORATE REPORTING

PROFESSIONAL 1 EXAMINATION - APRIL 2019

NOTES:
You are required to answer Questions 1, 2 **and** 3. You are also required to answer **either** Question 4 **or** 5. Should you provide answers to both Questions 4 and 5, you must draw a clearly distinguishable line through the answer not to be marked. Otherwise, only the first answer to hand for Question 4 or 5 will be marked.

Provided are pro-forma:

Statements of Profit or Loss and Other Comprehensive Income By Expense, Statements of Profit or Loss and Other Comprehensive Income By Function, and Statements of Financial Position.

TIME ALLOWED:
3.5 hours, plus 10 minutes to read the paper.

INSTRUCTIONS:
During the reading time you may write notes on the examination paper, but you may not commence writing in your answer book. **Please read each Question carefully.**

Marks for each question are shown. The pass mark required is 50% in total over the whole paper.

Start your answer to each question on a new page.

You are reminded to pay particular attention to your communication skills, and care must be taken regarding the format and literacy of your solutions. The marking system will take into account the content of your answers and the extent to which answers are supported with relevant legislation, case law or examples, where appropriate.

List on the cover of each answer booklet, in the space provided, the number of each question attempted.

NB: PLEASE ENSURE TO ENCLOSE YOUR ANSWER SHEET TO QUESTION 3 IN THE ENVELOPE PROVIDED.

THE INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS IN IRELAND

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You are required to answer Questions 1, 2 **and** 3. You are also required to answer **either** Question 4 **or** 5.
(If you provide answers to both questions 4 and 5 you must draw a clearly distinguishable line through the answer not to be marked. Otherwise only the first answer encountered by the examiner for questions 4 or 5 will be marked.)

You are required to answer Questions 1, 2 and 3.

1. The following financial statements relate to Trump Plc (Trump) and its investee companies, Knave Plc (Knave) and Deuce Plc (Deuce).

Statements of Profit or Loss and Other Comprehensive Income for year ended 31 March 2019

		Trump Plc	**Knave Plc**	**Deuce Plc**
		€ million	**€ million**	**€ million**
Revenue	...	800.0	320.0	140.0
Cost of Sales	...	(340.0)	(178.0)	(126.0)
Gross profit	...	460.0	142.0	14.0
Operating expenses	...	(114.0)	(64.0)	(6.0)
Finance costs	...	(20.0)	(12.0)	-
Other income	...	15.0	-	-
Dividends received	...	16.0	-	-
Profit before taxation	...	357.0	66.0	8.0
Taxation	...	(32.0)	(5.4)	(1.0)
Profit for the year	...	325.0	60.6	7.0
Other comprehensive income (amounts that will not be reclassified to profit or loss):				
Gains (losses) on remeasurement of financial assets		15.0	(4.0)	_
Total comprehensive income for the year		340.0	56.6	7.0
Reserve balances total at 1 April 2018		4,600.0	350.0	200.0
Equity share capital at 1 April 2018		2,000.0	500.0	100.0

The following additional information is provided:

(i) Trump bought a 60% holding in the equity of Knave on 1 October 2018. The purchase price of the investment was agreed at €750 million, of which €600 million was paid immediately. It was agreed that the balance of €150 million would be paid two years following the acquisition. Knave's net assets had a fair value of €898.3 million on 1 October 2018. This was represented by equity capital, reserves and an increase in the fair value of non-depreciable land over the carrying value (to be calculated as a balancing figure). The weighted average cost of capital for the group is 10%.

(ii) It was decided to apply the fair value method to calculate goodwill on acquisition. The non-controlling interest in Knave had a fair value of €380 million at the acquisition date. Impairment losses of €30 million were deemed to have arisen by 31 March 2019 in respect of the goodwill of Knave.

(iii) Trump has owned 40% of the equity shares in Deuce since incorporation. Trump has no representatives on Deuce's board of directors. However, Deuce manufactures a key component used by Trump. Trump purchases 75% of Deuce's production. Both companies work closely together, with Trump providing technical information and certain managerial services to Deuce.

(iv) During the year, Trump purchased goods from Deuce for €105 million. Deuce earns a 10% margin on goods sold to Trump. These goods were incorporated by Trump into its own products, which were sold at a profit. €10 million of the goods purchased from Deuce remained in the inventory of Trump at 31 March 2019.

(v) During the year, Trump sold €5 million worth of goods to Knave each month. Trump earned a 20% mark-up on cost on the goods sold to Knave. At 31 March 2019, Knave had sold all of these goods except €4.2 million of the most recent delivery. These goods remained in the inventory of Knave at 31 March 2019.

(vi) On 1 October 2018, immediately following the acquisition of Knave, Trump sold a piece of equipment to Knave for €40 million. This equipment had a carrying value of €25 million prior to the transfer. The gain on sale was shown as 'other income' in the books of Trump. The equipment had a five-year useful economic life remaining at the date of transfer.

(vii) On 1 March 2019, Knave declared and paid a dividend of €20 million out of post-acquisition profits. On the same date, Deuce declared and paid a dividend of €10 million. Trump recorded its share of both dividends as 'dividends received'.

(viii) All calculations may be taken to the nearest €0.1 million. Assume all expenses and income accrue evenly throughout the year unless otherwise instructed. No new equity capital was issued by any group company during the year.

(ix) Present Value Interest Factors for a 10% per annum interest rate are as follows:

1 year	0.909
2 years	0.826
3 years	0.751

REQUIREMENT:

(a) Calculate the goodwill on the acquisition of the shares in Knave as should be shown on the consolidated statement of financial position of the Trump Group on 31 March 2019, in accordance with IFRS. You should identify separately the amount of the fair value adjustment to the land.

(6 marks)

(b) How is it determined whether an investor exerts significant influence over an entity, according to IAS 28 - *Investments in Associates and Joint Ventures*. State, with reasons, whether or not Deuce is an associate of Trump?

(6 marks)

(c) Prepare a consolidated Statement of Profit or Loss and Other Comprehensive Income for the Trump Group for year ended 31 March 2019 in accordance with IFRS.

(16 marks)

(Format & Presentation: 2 marks)

[Total: 30 Marks]

2. Sanders Plc is a publicly listed wholesaler. Its summarised financial statements for the year ended 31 March 2019 (and 2018 comparatives) are as follows:

(Extract) Statements of Profit or Loss for the years ended 31 March:

	2019 € million	2018 € million
Revenue	65.0	60.0
Cost of sales	(30.0)	(28.0)
Gross profit	35.0	32.0
Operating costs	(11.0)	(8.0)
Investment income	2.2	2.0
Gain on disposal of equipment	12.0	-
Gains on revaluation of investment properties	5.8	10.0
Finance costs	(4.5)	(4.0)
Profit before taxation	39.5	32.0
Income tax expense	(4.9)	(4.5)
Profit for the year	**34.6**	**27.5**

Statements of Financial Position as at 31 March:

	2019 € million	2018 € million
Assets:		
Non-current assets:		
Property, plant and equipment	255.0	245.0
Investment properties	145.8	140.0
	400.8	385.0
Current assets:		
Inventory	6.5	5.2
Trade receivables	7.2	7.4
Bank	---	2.4
	13.7	15.0
Total assets	**414.5**	**400.0**
Equity and liabilities:		
Equity:		
Equity shares of €1 each	120.0	120.0
Share premium	155.0	155.0
Retained earnings	81.0	65.4
	356.0	340.4
Non-current liabilities:		
Debenture loan	45.0	50.0
Current liabilities:		
Trade payables	5.6	5.1
Bank overdraft	4.5	---
Current tax payable	3.4	4.5
	13.5	9.6
Total equity and liabilities	**414.5**	**400.0**

Additional Information:

One of your clients is considering investing in Sanders Plc and has requested your assistance. She has provided you with the draft financial statements for year ended 31 March 2019 which have just been produced. You ascertain the following information regarding the company's performance.

(i) Sanders Plc has traditionally been very successful but has struggled in recent years due to a shortage of new innovative products compared to its competitors. It has a good brand and reputation, but the value of this is not recognised on the Statement of Financial Position.

(ii) Some equipment was sold during January 2019 at a profit of €12 million. The carrying value of this equipment was €10 million at the date of sale.

(iii) Depreciation for the year was €7 million.

(iv) The debenture loan was due for repayment on 31 March 2020. However, on 1 April 2018, the lender agreed through a refinancing deal to accept a 10% repayment and extend the balance outstanding for a further three years to 2023, but at a higher interest rate.

(v) Sanders Plc suffered some negative publicity, and as a result the directors agreed to pay a large special dividend on 31 March 2019.

(vi) The investment income represents rent receivable from the investment properties. Sanders Plc has not raised its rents for several years. Normal yields in the market are in the region of 6%.

REQUIREMENT:

(a) Calculate Sanders Plc's net cash flow generated from operating activities in accordance with IAS 7 - *Statement of Cash Flows*. You are NOT required to prepare the entire Statement of Cash Flows for Saunders Plc.

(6 marks)

(b) Calculate at least eight suitable ratios for both financial years in order to assist in assessing Sanders Plc as a potential investment.

(8 marks)

(c) Prepare a report for your client which analyses and discusses the financial performance and position of Sanders Plc as portrayed by the above financial statements and your workings for part (b) and the additional information provided.

(14 marks)

(Format & Presentation: 2 marks)

[Total: 30 Marks]

3. ***The following multiple-choice question contains eight sections, each of which is followed by a choice of answers. Each question carries equal marks. On the answer sheet provided, indicate for each question which of the options you think is the correct answer. Marks will not be awarded where you select more than one answer for any question.***

REQUIREMENT:
Record your answer to each section on the answer sheet provided.

1. IAS 40 - *Investment Properties* sets out the accounting treatment required for properties that meet the definition of investment properties. The entity may choose the Cost Model or the Fair Value Model under IAS 40. Which of the following is correct in the case of the Fair Value Model?

   (i) Depreciation is not charged on investment properties.
   (ii) Gains and losses on annual revaluations are taken to other comprehensive income.

(a) (i) only
(b) (ii) only
(c) Both (i) and (ii)
(d) Neither (i) nor (ii).

2. IAS 1 - *Presentation of Financial Statements* sets out its requirements for a complete set of financial statements. Which one of the following is NOT one of these requirements?

(a) The Statement of Profit or Loss and Other Comprehensive Income
(b) The Statement of Changes in Equity
(c) Notes to the financial statements
(d) The directors' report.

3. Mueller Plc has been awarded a government grant to assist with the purchase of some specialised equipment. The equipment has been purchased and is already in use. The cost of the equipment was €20 million, and it has been depreciated by 10% by the reporting date 31 March 2019. The grant of €12 million has been sanctioned by the government agency responsible, and all associated conditions have been met by Mueller Plc. Payment has not yet been received as at the reporting date. Which of the following is correct under IAS 20 - *Accounting for Government Grants and Disclosure of Government Assistance*?

(a) €12 million should be recognised as receivable, and the same amount as deferred income.
(b) €12 million should be recognised as receivable, €1.2 million as income, and €10.8 million as deferred income.
(c) Nothing should be recognised in respect of the grant.
(d) €12 million should be recognised as receivable and the same amount as income in profit or loss.

4. IFRS 5 - *Non-Current Assets Held for Sale and Discontinued Operations* sets out guidance for dealing with assets held by the entity where the economic benefits will be realised primarily through a sale rather than through continuing use. On 31 March 2019, Jared Plc has a property which meets all the criteria to be classified as 'held for sale' under IFRS 5. It is currently carried at its depreciated historic cost of €14.5 million. The company has estimated the fair value of the property at €20 million and that disposal costs will be €0.5 million.

   How should the property be treated in the financial statements as at 31 March 2019?

(a) Include within current assets at a value of €14.5 million.
(b) Include within non-current assets at a value of €14.5 million.
(c) Include within current assets at a value of €19.5 million.
(d) Include within non-current assets at a value of €19.5 million.

5. During the financial year ended 31 March 2019, Marty Plc sold goods at an invoice value of €60,000 to a customer on a 'sale or return' basis. This included a profit margin of 30%. No payment was received. At 31 March 2019, the goods had not yet been sold on by the customer.

Under IFRS 15 - *Revenue from Contracts with Customers*, how much should Marty Plc report as revenue, as trade receivables and as inventory in respect of the above goods?

	Revenue	**Trade Receivables**	**Inventory**
(a)	€60,000	€60,000	zero
(b)	zero	zero	zero
(c)	zero	zero	€60,000
(d)	zero	zero	€42,000

6. IAS 37 - *Provisions, Contingent Liabilities and Contingent Assets* sets out the principles for recognising and measuring provisions. IAS 37 requires that, in cases where the time value of money is material, the provision be measured at present value at the reporting date.

Paul Plc has an obligation to restore a site following the completion of mining works currently under way. The estimated cost of these works is €30.225 million, and the works are expected to be completed on 1 April 2028. Using the company's cost of capital of 8%, the present value of the restoration cost was recorded at €14.0 million on 1 April 2018. What adjustment should be recorded at 31 March 2019, Paul's reporting date, to ensure the provision is correctly accounted for?

(a) Debit provision for restoration €1.12m, Credit profit or loss €1.12m.
(b) Debit profit or loss €1.12m, Credit provision for restoration €1.12m.
(c) Debit provision for restoration €2.42m, Credit profit or loss €2.42m.
(d) Debit profit or loss €2.42m, Credit provision for restoration €2.42m.

7. IFRS 10 - *Consolidated Financial Statements* sets out the requirements for the consolidation of entities under the control of the reporting entity. In which of the following scenarios is control deemed to exist according to IFRS 10?

(i) The reporting entity owns 40% of the voting equity in Murphy Ltd., and has the right to appoint six directors to the board of ten.
(ii) The reporting entity owns 60% of the voting equity in McSwiggan Ltd., and appoints only four directors to the board of ten.

(a) (i) only
(b) (ii) only
(c) Both (i) and (ii)
(d) Neither (i) nor (ii).

8. Under IFRS 12 - *Disclosure of Interests in Other Entities*, a structured entity is defined as one designed so that voting or similar rights are not the dominant factor in deciding who controls the entity. Which of the following would meet the definition of a structured entity? *(Note: DAC stands for Designated Activity Company, a type of company introduced by Part 16 of the Companies Act 2014.)*

(i) Limetree DAC is an entity set up by a sponsoring bank to hold specific mortgages, securitised by that bank. The operation of Limetree DAC is governed by an operating agreement that sets out the managerial structure and rules of operation.
(ii) Jakarta DAC is a 100% owned subsidiary set up by a bank to source deposits in Indonesia. It is managed by directors appointed by the bank. Normal commercial rules apply to Jakarta DAC.

(a) (i) only
(b) (ii) only
(c) Both (i) and (ii)
(d) Neither (i) nor (ii).

[Total: 20 marks]

Answer <u>either</u> Question 4 <u>or</u> Question 5

4. IAS 33 - *Earnings per Share* sets out the requirements for calculating and disclosing the basic earnings per share figure for quoted entities.

The following figures were extracted from the financial statements of Gurney Plc:

Statement of Profit or Loss and Other Comprehensive Income for year ended 31 March 2019 (Extract)	**€ million**
Profit before taxation	275
Taxation	(35)
Profit for the year	240
Other comprehensive income for the year	25
Total comprehensive income for the year	265
Non-controlling interests' share of profit for year	32

Other Information:

Equity dividends paid	67
Preference dividends paid out of equity (none paid to non-controlling interests)	12
Issued equity share capital at 1 April 2018 (nominal value €1 per share)	125
Issued 6% preference shares at 1 April 2018	200

During the year ended 31 March 2019, the following transactions took place to the issued share capital of Gurney Plc:

(i) 10 million equity shares were issued in conjunction with the acquisition of another business. These were issued at full market price at the date of issue, 1 July 2018.

(ii) 20 million ordinary shares were issued for cash to existing shareholders on 1 October 2018. The issue price was €14 per share, which represented a discount of 30% on the traded price immediately before the issue (€20 per share).

(iii) On 1 March 2019, Gurney Plc re-purchased 5 million shares at full market value.

(iv) On 31 March 2019, a bonus issue was completed issuing 3 new shares for every equity share in issue at that date.

REQUIREMENT:

(a) Outline how IAS 33 requires the earnings figure to be determined for the purpose of calculating earnings per share.

(6 marks)

(b) Using the information provided, calculate the basic EPS for year ended 31 March 2019 and the comparative figure for 2018 to be reported in the 2019 financial statements. The EPS figure originally reported in 2018 was €1.60.

(14 marks)

[Total: 20 Marks]

<u>**OR**</u>

5. IAS 16 - *Property Plant & Equipment* sets out the accounting requirements for most tangible non-current assets. It requires that an annual charge be made to profit or loss reflecting the amount of economic benefit associated with the asset consumed during the period. IAS 16 also permits non-current assets to be revalued to fair value, should a reporting entity choose the fair value model. It also specifically requires that revaluations, however regular, do not eliminate the need for a depreciation charge.

REQUIREMENT:

(a) Outline how IAS 16 requires an entity to calculate the depreciation charge on its property plant and equipment.

(5 marks)

(b) Explain, with reference to the requirements of IAS 16, why it is not appropriate to allow regular revaluations to replace depreciation charges.

(5 marks)

(c) Huckabee Plc, a hotel operator, acquired a hotel asset on 1 April 2017 at a cost of €50 million. This cost was allocated as follows:

	€ million	**Useful Economic Life**
Land	12	Indefinite
Building	25	50 years
Furniture and fittings	10	10 years
Inventory of retail products	3	Until sold
Total	50	

Year ended 31 March 2018:
A renovation of Huckabee Plc's property was carried out on 1 April 2017 at a cost of €10 million. €3 million of this cost was allocated to the building and €7 million as additional furniture and fittings. A full year's depreciation was charged for year ended 31 March 2018. The inventory was sold for €5 million during that year.

Year ended 31 March 2019:
The hotel property was revalued on 1 April 2018 to €74 million. The revaluation was conducted by a professional who produced the following breakdown:

	€ million	**Useful Economic Life**
Land	18	Indefinite
Building	40	50 years
Furniture and fittings	16	8 years
Total	74	

You are required to show the journal entries necessary to record the above transactions and events in the financial statements of Huckabee Plc for years ended 31 March 2018 and 2019. Any entry affecting the performance statement must be clearly identified as either "profit or loss" or "other comprehensive income". Huckabee adopts the revaluation model of IAS 16 whenever it is permitted to do so. Show workings for all figures calculated. No residual values are expected except for the land.

(10 marks)

[Total: 20 Marks]

END OF PAPER

SUGGESTED SOLUTIONS

THE INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS IN IRELAND

CORPORATE REPORTING

PROFESSIONAL 1 EXAMINATION – APRIL 2019

SOLUTION 1

Marking Scheme:

(a)	Goodwill under IFRS	
	Calculation of goodwill on acquisition – basic issues	2
	Calculation of deferred consideration	1
	Calculation of fair value adjustment	2
	Treatment of impairment loss	1
	Subtotal	**6**
(b)	Discussion of significant influence	
	Indicators of significant influence per IAS 28	4
	Application to Deuce	2
	Subtotal	**6**
(b)	Statement	
	Basic consolidation plan (100% Trump + 100% Knave * 6/12)	4
	Goodwill impairment (inclusion in expenses)	1
	Cancellation of intra-group gain on transfer of equipment (net of depreciation)	2
	Intra-group revenue and purchases (exclusion)	2
	Unrealised profit on intra-group trading (calculation and elimination)	2
	Finance cost on deferred consideration	1
	Calculation and recognition of share of results of associate (incl adjustments)	2
	Calculation and attribution of results to NCI and owners of parent	2
	Exclusion of intra-group dividends	1
	Presentation	2
	Subtotal	**19 max 18**
	Overall total	**30**

SUGGESTED SOLUTION

(a)	Calculation of goodwill on acquisition of Knave under IFRS:		€ million
	Cost of investment - cash		600.0
	Cost of investment – deferred at present value (PV of 150 for 2 yrs at 10%)		123.9
	Fair value of NCI		380.0
	Fair value of net assets at acquisition:		
	Equity capital	500	
	Reserves (350 + (56.6 * 6/12))	378.3	
	Fair value adjustment – Land (balancing figure)	20	
			(898.3)
	Goodwill		205.6
	Impairment loss 31 March 2019 (to operating expenses)		(30.0)
	Recoverable amount 31 March 2019 (to SOFP)		175.6

(b) Significant influence by an investor is presumed to exist if the investor has a holding of 20% or more of the voting power of the investee, but does not have the ability to exert control. However if it can be demonstrated clearly that significant influence does not exist in substance, the relevance of the percentage ownership disappears.

The existence of significant influence is evidenced by one or more of the following:

1. The investor has representation on the board of directors;
2. The investor participates in the policy-making process in ways more significant than a normal shareholder at AGM;
3. Material transactions take place regularly between investor and investee;
4. There is interchange of managerial personnel between the entities;
5. There is provision of essential technical information between the entities.

In the case of Deuce, the 40% shareholding is indicative of significant influence. In addition, although Trump has no representatives on the board of Deuce, there are three other indicators of influence present. In particular, Trump buys 75% of Deuce's production, provides technical information and managerial expertise to Deuce.

These would suggest that Trump exerts significant influence over Deuce, and accordingly, that Deuce is an associate of Trump.

Trump Plc: Consolidated Statement of Profit or Loss and Other Comprehensive Income for year ended 31 March 2019

	100% Trump + 100% Knave * 6/12	**Adjustments**	**€ million**
Revenue	(800 + 160	-30 (v)	930.0
Cost of Sales	(340 + 89	-30 + 0.7 (v)	(399.7)
Gross Profit			530.3
Operating expenses	(114 + 32	+30 (iii)	(176.0)
Finance costs	(20 + 6	+6.2 (viii)	(32.2)
Other income	(15	-13.5 (vi)	1.5
Dividends received	(16	-16 (vii)	0.0
Share of results of associate		2.4 (iv)	2.4
Profit before taxation			326.0
Taxation	(32 + 2.7)		(34.7)
Profit for the year			291.3
Other Comprehensive Income (Amounts that will not be reclassified to profit or loss)			
Gains on remeasurement of financial assets	(15 - 2)		13.0
Total comprehensive income for the year			304.3
Profit for the year is attributable to:			
Owners of the parent			291.2
Non-controlling interests	(ii)		0.1
			291.3
Total Comprehensive Income is attributable to:			
Owners of the parent			305.0
Non-controlling interests	(ii)		(0.7)
			304.3

Working (i): Group structure:

Trump plc – Parent

Knave plc – 60% ownership interest acquired by Trump 6 months into the financial year. Hence Knave is a subsidiary of Trump for 6 months of year. Therefore, include 100% of results, time apportioned by 6/12. NCI = 40%.

Deuce plc – 40% ownership interest acquired by Trump several years ago. Significant influence exerted due to significant transactions and interchange of managerial personnel. Therefore, Deuce is an associate of the group. Include as single-line adjustments 40% of profit for year, for the full year.

Working (ii) – non-controlling interest	**Profit € million**	**TCI € million**
Knave total per SPLOCI given * 6/12	30.3	28.3
Goodwill impairment (Wiii)	(30.0)	(30.0)
Adjusted figures	0.3	(1.7)
NCI percentage	40%	40%
NCI amount	0.12	(0.68)

Working (iii) – goodwill impairment
Impairment loss on consolidated goodwill €30 million is included as operating expense in year of recognition. NCI is affected as the fair value method was used to calculate goodwill.

Note: Goodwill may be included in cost of sales for full credit.

Working (iv) – Share of results of associate	**€ million**
Profit for year generated by associate	7
Trump's share of profit for year of associate (€7m * 40%)	2.8
Intra-group trading adjustment (€10m * 10% * 40%)	(0.4)
Net income recognised from associate	2.4

NCI is not affected as the associate is owned by the parent.

Working (v) – Intra-group trading with Knave	**€ million**
Total intra-group trading for year (post-acquisition period only) (€5m * 6)	30
Unrealised profit (€4.2m * 20/120)	0.7

Deduct €30 million from group revenue and cost of sales.
Add €0.7 million to group cost of sales expense this year.

NCI is not affected as Trump was the internal seller.

Working (vi) – intra-group transfer of equipment	**€ million**
Unrealised gain on disposal of equipment to Knave	15
Extra depreciation charged by Knave as a result (€15m * 20% * 6/12)	(1.5)
Net adjustment to Trump's profit – reduce by	13.5

NCI is not affected as Trump (parent) was the internal selling company that recorded the gain.

Note:
It could be argued that Knave gained from the depreciation adjustment, and that Knave's NCI should share in this. Technically this is inaccurate, as the gain will ultimately revert to Trump in its entirety once the asset is completely depreciated. However candidates following the above line of reasoning will not be penalised.

Working (vii) – intra-group dividends	**€ million**
Trump's share of Knave's dividend (€20m * 60%)	12
Trump's share of Deuce's dividend (€10m * 40%)	4
Eliminate intra-group dividends	16

Note:
Although Deuce is not a group company, the share of profit of associates is recognised before dividends are deducted. Hence to recognise dividends received or receivable from associates is double counting these amounts, as it is for subsidiaries.

Working (viii) – finance costs on deferred consideration	**€ million**
Amount of deferred consideration arising at acquisition (per part (a))	123.9
Finance cost arising from 1 Oct 2018 to 31 Mar 2019 (€123.9m * 10% * 6/12))	6.2

Note: It could be reasonably argued that Trump may have already recorded the finance cost on deferred consideration, and that an adjustment might not be required. Hence the mark assigned to this adjustment is in addition to the 18 marks allocated to part (c). Hence the candidate not making the adjustment may still score full marks.

SOLUTION 2

Marking Scheme:

(a)	Cash flow from operations	
	Profit before taxation	0.5
	Gains on revaluation of investment properties	0.5
	Gains on disposal of equipment	0.5
	Depreciation	0.5
	Investment income	0.5
	Finance costs	0.5
	Increase in inventory	0.5
	Decrease in trade receivables	0.5
	Increase in trade payables	0.5
	Taxation paid	1.0
	Presentation	0.5
	Subtotal	6
(b)	Ratio calculation: 8 appropriate ratios for each year	8
(c)	Report	
	Analysis at appropriate breadth and depth	14
	Presentation	2
	Total	30

(a) Sanders Plc: Net Cash Flow from Operating Activities for year ended 31 March 2019

	€ million
Profit before taxation	39.5
Finance costs	4.5
Investment income	(2.2)
Gains on revaluation of investment properties	(5.8)
Gains on disposal of equipment	(12.0)
Depreciation	7.0
Increase in inventory	(1.3)
Decrease in trade receivables	0.2
Increase in trade payables	0.5
	30.4
Interest paid	(4.5)
Dividends paid (possible – not required)	(19.0)
Taxation paid (4.5 + 4.9 – 3.4)	(6.0)
Net cash flow from operating activities	0.9 or 19.9

Note:
Investment income is excluded on the basis that it belongs within investing activities.
It is acceptable to include dividends paid, but these are more normally included within financing activities.

(b) Ratio calculation

	y/e 31 March 2019	y/e 31 March 2018	2019 adjusted for disposal gain
Gross margin	35/65 = 54%	32/60 = 53%	
Net margin	44/65 = 68%	36/60 = 60%	(44-12)/65 = 49%
ROCE	44/(356+45) = 11%	36/(340.4+50) = 9.2%	(44-12)/(316+45) = 8.9%
ROE 34.6/356 = 9.7%	27.5/340.4 = 8.1%	(34.6-12)/316 = 7.2%	
Current ratio	13.7:13.5 = 1.01:1	15:9.6 = 1.6:1	
Acid Test	(13.7-6.5):13.5 = 0.53:1	(15-5.2):9.6 = 1.02:1	
Inventory days	6.5/30*365 = 79 days	5.2/28*365 = 68 days	
Receivables days	7.2/65 * 365 = 40 days	7.4/60 * 365 = 45 days	
Payables days	5.6/30*365 = 68 days	5.1/28*365 = 66 days	
Gearing Ratio	45/356 = 12.6%	50/340.4 = 15%	
Operating costs / sales	11/65 = 16.9%	8/60 = 13.3%	
Interest cover	(39.5 +4.5)/4.5 = 9.8 tms	(32+4)/4 = 9 times	

Note: Any 8 of the above would qualify for full marks. Other ratios are potentially acceptable also.
Note: Exclusion of gains on revaluation would merit the award of credit also.

Report:
To: HG investments Ltd
From: H Hugger, Accountant
Re: Analysis of performance of Sanders plc for year ended 31 March 2019.
Date: 30 April 2019.

Dear Client,
I am pleased to present to you my report into the performance of Sanders Plc for the past two years. I have taken the liberty of making comparisons between the two years, and tentative projections, based on information provided by yourselves.

I will address performance under the following headings, which are customary for this type of report. These are:
Profitability;
Liquidity;
Gearing; and
Efficiency.

Calculations and supporting data are provided in an appendix to this report, should you wish to refer to them.

<u>Profitability</u>
The first point that should be made is that Sanders plc is highly profitable under almost all standard measures.

Gross margin and net margin are exceptionally high, and should the business grow as projected, will lead to very fast growing profits. Gross margins were 53% in 2018, increasing slightly to a 54% in 2019.

You have the very unusual scenario that net margins are higher than gross margins. The reason for this is the performance of the investment property portfolio, as well as the one-off gain on disposal. This impairs the usefulness of this ratio as a performance measure.
Recalculating the net margin excluding these items (using operating profit as a percentage of sales) gives 37% in 2019 (24/65) and 40% in 2018 (24/60). A small decrease is evident, due to the relatively bigger increase in operating costs. However the overall level is very satisfactory.

Return on capital employed is reasonable, although not exciting. ROCE appeared to increase in 2019, but if the one-off disposal gain is excluded, the return declined over 2018. This is despite the reduction in capital due to the one-off dividend, as well as the reduction in debt, both of which would have the effect of increasing the ROCE ratio (by decreasing the denominator in the calculation).

Return on equity is lower than ROCE, suggesting that the business is not using borrowed funds effectively to leverage equity. This view is supported by measuring the cost of debt, which was 8% in 2018 and 10% in 2019 after the refinance. It is probably just as well that the overall debt burden is low.

Liquidity
The liquidity of Sanders plc has disimproved significantly over the past year.
The current ratio went from 1.6:1 to 1:1. The acid test (quick) ratio likewise declined from 1:1 to 0.53:1. These changes transform the ratios from being very satisfactory in 2018 to approaching danger territory in 2019.

This change is mainly due to the repayment of €5 million in debt, and the payment of a significant one-off dividend. It seems to this analyst that the debt refinance was probably wise, but the dividend was an unfortunate use of badly-needed funds. The amount can be calculated by examining the movement in the retained earnings reserve. The opening balance plus profit would suggest an expected balance at 31 March 2019 of (65.4 + 34.6) €100 million. The actual balance of €81 million suggests a dividend of €19 million was paid.

Gearing
Longer term liquidity is measured by the gearing ratio. This remains very conservative, at 15% in 2018, falling to 14% in 2019. However, as mentioned above, the cost of this debt is high at 10%. It exceeds the return on capital. There are steps I can recommend to improve this, as discussed below.

Efficiency
This is an area I recommend some close attention be paid. There seems to be some weaknesses in the management of working capital.

Inventory days appear to be high, and disimproving. There may be valid reasons for this. However, I recommend examining this to see if improvements can be made.

This does appear to be compensated for somewhat by longer payables days. If goods are spending a long time in inventory, and yet your firm has not paid for them, this is cash neutral. It may be worth checking if the price paid would be cheaper if goods were paid for more quickly. There is often a hidden costs to long payables days, in that a higher price than necessary may be charged by suppliers.

Receivables days, in contrast, look to be well managed. 40-45 days is pretty reasonable so there is little scope for cash flow improvement here.

Outlook for the future
Despite the challenges identified in the foregoing paragraphs, there are bright opportunities for Sanders Plc to improve its financial position. Operating cash flow is running at €22 million in 2019. If this is replicated in 2020 it would solve much of the liquidity problem caused by the special dividend. If this transpires, it might be worth looking at early repayment of the debt, as the cost is very high.

Another area worth looking at is the return on the investment portfolio. I am informed that rents charged have not increased for several years, and that normal yields for assets of the type held by Sanders have an expected yield of 6%. Based on current carrying value as recently revalued, that would suggest rental income of €8.75 million is achievable. (145.8 * 6%) This is nearly a 300% increase on current levels!

Conclusion
The company's figures look exceptionally poor at face value, and some poor decisions have been made by the management of Sanders Plc. If the share price has been correspondingly weak, this may represent an opportunity for an investor such as yourself to buy in, and either put pressure on management to take the steps necessary to improve performance or seek election to the board where direct influence could be exerted.

As always, should you have any further questions, or would like further work done, please contact me at any time.

SOLUTION 3

Marking scheme:

8 parts * 2.5 mark each	20
Total	20

Suggested solution:

Part 1: Answer **(a)**
Gains and losses on investment properties are taken to profit or loss under IAS 40. Hence (ii) is false.

Part 2: Answer **(d)**
Directors' report is not a requirement of IAS 1.

Part 3: Answer **(b)**
Grants received or receivable in respect of capital assets should be recognised within income in the same period as the underlying asset is recognised in expenses. So if 10% of the asset is expensed, 10% of the grant is recognised as income. The balance is deferred income. The fact that the grant is not yet received is irrelevant, as long as all conditions are met, and it is expected to be received.

Part 4: Answer **(a)**
Assets qualifying to be presented as "held for sale" should be carried within current assets at the lower of (i) their carrying value immediately prior to transfer (€14.5m) and (ii) their fair value less costs to sell (€19.5m).

Part 5: Answer **(d)**
Under IFRS 15 revenue is only recognised when the risks and rewards associated with the goods have transferred to the new owner, and it is probable that the economic benefit will flow to the entity. If the customer has an unconditional right to return the goods, the risk remains with the seller, and there is no economic benefit owed to the seller until the buyer confirms they are not returning the goods.

Hence no revenue is recognised, no trade receivable, and the goods should be included in inventory at cost price (€60,000 – 30% = €42,000)

Part 6: Answer **(b)**
Any amount recorded at the present value of future cash flows should be adjusted as time passes. The adjustment allows for the fact that the time to maturity is shorter. The adjustment is measured as the opening balance multiplied by the original discount rate. Another method, which would give the same answer, would be to recalculate the discounted amount using the same discount rate but the shorter period.

Here €14 million * 8% gives €1.12 million. This is charged (debited) to profit or loss (finance costs) and increases the present value of the provision (credit entry).

Part 7: Answer **(c)**
Under IFRS 10, control exists when the investor has the power to affect its returns through its influence over the investee. Power and control may be achieved several ways. The percentage equity holding is but one way to achieve control. Although it is presumed that a majority of the voting rights gives an investor such power, it is not the case that the absence of a majority proves absence of control.

In scenario (i), the reporting entity controls the other entity through a majority of seats on the board. In scenario (ii) control is achieved because the investor has the power to appoint a majority of the board, even if it chooses not to.

Part 8: Answer **(a)**
Scenario (i) clearly meets the definition stated in the question, as control is determined by the operating agreement. Scenario (ii) equally clearly does not, as control is determined by voting rights.

SOLUTION 4

Marking scheme:

(a)	Earnings attributable to equity shareholders, after tax	3
	After preference dividends	1
	After non-controlling interests	1
	Excluding other comprehensive income	1
	Subtotal	6
(b)	Calculation of correct earnings figure	3
	Calculation of weighted average number of equity shares in issue	6
	Calculation of EPS	2
	Calculation of comparative figure	3
	Subtotal	14
	Overall total	20

Suggested solution

(a) According to IAS 33, the earnings figure for EPS purposes should be the profit for the year attributable to the equity shareholders of the group.

In practice, this normally consists of profit after tax, after exceptional items, after any preference dividends are declared, but before any equity dividends.

It must also be adjusted to exclude non-controlling interests, if any, in that profit.

(b)	Earnings calculation:	**€ million**
	Profit for the year (after tax)	240
	Less non-controlling interests	(32)
	Less preference dividends paid	(12)
	Earnings for EPS purposes	196
	Total number of equity shares in issue for the year:	million
	No. of equity shares in issue at 1 April 2018	125
	New shares issued on acquisition	10
	New shares issued for cash	20
	Shares repurchased (treated as cancelled)	(5)
	Total before bonus issue	150
	Bonus issue 3 for 1	450
	Total number of equity shares at 31 March 2019	600

Weighted average calculation:

Dates	**Number of shares (million)**	**Time weighting**	**Bonus fractions (see W1 below)**	**Weighted average (million)**
1 Apr – 1 July	125	*3/12	*20 / 19.23 *4/1	130.01
1 July – 1 Oct	125 + 10 = 135	*3/12	*20 / 19.23 * 4/1	140.41
1 Oct – 1 Mar	135 + 20 = 155	*5/12	*4/1	258.33
1 Mar – 31 Mar	155 - 5 = 150	*1/12	*4/1	50.00
31 Mar	150 + 450 = 600	0		0
Total				578.75

W1: Bonus fractions are required for shares issued at discount to market value.

<u>Rights Issue:</u>
On 1 October 2018, 20 million shares were issued to existing shareholders at a discounted price. The bonus fraction is calculated as the actual price before the rights issue divided by the theoretical ex-rights price (TERP). We need to calculate the TERP.

There were 135 million shares in issue before the rights issue. Hence it is fair to say that every shareholder with 135 shares was offered 20 new shares.

Value of holding prior to rights issue:	135 * €20	= €2,700
Value added by rights issue:	20 * €14	= €280
Total value after rights issue:	155 shares	= €2,980

Hence the TERP is €2,980 / 155 shares	= €19.23 per share
Therefore the bonus fraction is	= 20 / 19.23

This is applied to all periods prior to the rights issue.

<u>Bonus Issue:</u>
The bonus fraction for the bonus issue is the number of shares in issue after the bonus issue divided by the number of shares in issue before. Here, 600/150 or 4/1.

Basic earnings per share = 196 / 578.75 = €0.339 or 39c

<u>Restate 2018 comparative:</u>
In order to adjust the comparative figure, we must multiply it by the inverse of both bonus fractions.

Hence €1.60 *19.23/20 * ¼ = €0.3846 or 38c

SOLUTION 5

Marking scheme:

(a)	Any 5 valid points @ 1 mark each	5
	Subtotal	5
(b)	Any 3 valid points @ 2 marks each - maximum	5
	Subtotal	5
(c)	Capitalising €47 million + €10 million (exclude inventory)	2
	Depreciation for y/e 31 March 2018	2
	Revaluation 1 April 2018	4
	Depreciation for y/e 31 March 2019	2
	Subtotal	10
	Overall total	20

Suggested solution:

(a) A charge (debit) should be made to operating profit equivalent to the cost or revalued amount of the economic benefits of tangible fixed assets consumed during the period. This is matched by a credit to the accumulated depreciation account for that asset type. The specific heading within operating profit should be determined by judgment.

The amount is arrived at by allocating the depreciable amount of an asset systematically over its UEL. No particular method is prescribed, but the method chosen should reflect the pattern in which the asset's future economic benefits are expected to be consumed by the entity.

Depreciable amount = cost (or valuation if revalued) less residual value.

The residual value of an asset is the estimated amount that an entity would currently obtain from disposal of the asset, after deducting the estimated costs of disposal, if the asset were already of the age and in the condition expected at the end of its useful life.

All tangible fixed assets except land (unlimited UEL), investment properties (covered by IAS 40), and assets classified as held for sale (covered under IFRS 5) must be depreciated.

It is acceptable not to depreciate assets if the amount is immaterial. However if this is the case an annual impairment review must be carried out to ensure the carrying value of the asset does not exceed its recoverable amount.

Similarly, an annual impairment review must be carried out if the UEL exceeds 50 years.

If the depreciation method, UEL or residual value estimate is changed, this is NOT a change of accounting policy. It is a change of accounting estimate. Therefore no prior year adjustment is needed. The new estimates are simply applied to the carrying amount at the date of the change from that date onwards.

IAS 16 requires the splitting of assets into components which may have different UELs, if the components are significant in value relative to the total cost of the asset.

(b) Revaluations are conceptually different from depreciation charges. As noted above, depreciation is the periodic charge to profit or loss of the amount of an asset consumed during a period.

A revaluation is the remeasurement of the market value of the unconsumed remainder of the asset.

Revaluations are treated differently to operating costs, hence it is not appropriate to mix them up.

Illustration for tutorial purposes:
The amount of an asset consumed is not affected by any change in its market value. To illustrate this, imagine an asset such as a gravel pit, which contains a definite amount of gravel, say 10 million tonnes. If gravel is worth €10 per tonne at the date of purchase, the asset has an initial value of €100 million.

Let's say in year 1, 1.5 million tonnes of gravel are extracted, leaving 8.5 million tonnes. As 15% of the gravel is gone it seems reasonable to charge 15% of the cost of the asset to profit or loss as depreciation, or €15 million. The carrying value is now €85 million.

If, at the end of year 1, the price of gravel has risen to €15 per tonne, the year end value of the gravel pit is now €127.5 million.

If we didn't charge depreciation, the operating results would be distorted.

We account for the market value increase by recognising a revaluation gain. This is calculated as the difference between the new value and the carrying value (127.5 – 85 = 42.5m). This is basically the market value increase of the remaining gravel. It is not appropriate that this should have any effect on operating results. Hence it is credited to OCI.

(c) Year ended 31 March 2018:

	€ million	**€ million**
1 April 2017 – purchase and initial recognition:		
Dr Property plant & equipment	47	
Dr Inventory	3	
Cr Cash		50
(purchase of hotel and classification as non-current assets and inventory)		
1 April 2017 – renovation:		
Dr Property plant & equipment	10	
Cr Cash		10
(renovation cost, all capitalised to non-current assets)		
Sometime during the year – sale of inventory:		
Dr Cash / receivables	5	
Cr Revenue		5
31 March 2018 – depreciation for year:		
Dr Profit or loss	2.26	
Cr Accumulated Depreciation		
(depreciation charged for year – see calculation below)		2.26

Working: Depreciation is calculated on a component basis as follows:

Component	**Cost**	**Useful Economic Life**	**Depreciation for year**
Building	25 + 3 = 28m	50 years	€0.56 m
Furniture & Fittings	10 + 7 = 17m	10 years	€1.7 m
Total			€2.26 m

Year ended 31 March 2019

1 April 2018 – Revaluation		
Revalued amount	74	
Carrying value (47 + 10 – 2.26)	(54.74)	
Gain on revaluation	19.26	

	€ million	**€ million**
Dr Property plant & equipment (74 – 57)	17	
Dr Accumulated Depreciation	2.26	
Cr Other Comprehensive Income (OCI)		19.26
(revaluation gain credited to OCI)		
31 March 2019 – Depreciation for year:		
Dr Profit or loss	2.8	
Cr Accumulated Depreciation		
(depreciation charged for year – see calculation below)	2.8	

Working: Depreciation is calculated on a component basis as follows:

Component	Cost / valuation	Useful Economic Life	Depreciation for year
Building	40m	50 years	€0.8 m
Furniture & Fittings	16m	8 years	€2.0 m
Total			€2.8 m

Tutorial notes:

- Accumulated depreciation is reset to zero every time there is a revaluation.
- Revaluation gains are credited to OCI, and revaluation reserve, unless they reverse previous losses charged to profit or loss.
- The hotel is a single asset, hence the revaluation gain or loss is calculated as a single figure, albeit in stages through the various components.
- The following overall working may be useful to keep track of all the adjustments. Events should be recorded in chronological order, as they happen.

Additional working:

	Land €m	Building €m	Furniture €m	Total €m
Purchase 1 Apr 2017	12	25	10	47
Renovation 1 Apr 17	0	3	7	10
Depreciation to 31 Mar 18	0	(0.56)	(1.7)	(2.26)
Carrying value 1 Apr 18	12	27.44	15.3	54.74
Revaluation 1 Apr 18	6	12.56	0.7	19.26
Revised carrying value	18	40	16	74
Depreciation to 31 Mar 19	0	(0.8)	(2)	(2.8)
Carrying value 31 Mar 19	18	39.2	14	71.2