IRELAND

CORPORATE REPORTING

PROFESSIONAL 1 EXAMINATION - AUGUST 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. Lowry Plc (Lowry) is a public limited company based in Ireland with shareholdings in two other companies, Moran Plc (Moran) and Lucas Plc (Lucas). Statements of Financial Position are shown below for all three companies as at 31 July 2019.

Statements of Financial Position as at 31 July 2019

	Lowry Plc € million	Moran Plc € million	Lucas Plc € million
Non-current assets:			
Property, plant & equipment	758	326	159
Investments	1,200	40	25
	1,958	366	184
Current assets:			
Inventories	235	153	65
Trade receivables	188	134	42
Cash & bank	100	36	20
	523	323	127
Total assets	**2,481**	**689**	**311**
Equity:			
Equity share capital of €1 each	1,000	400	100
Other equity reserves	200	30	80
Retained earnings	977	112	70
	2,177	542	250
Current liabilities:			
Contingent consideration	38	---	---
Trade payables	161	127	46
Taxation	25	20	15
Dividends proposed	80	---	---
	304	147	61
Total equity & liabilities	**2,481**	**689**	**311**

The following additional information should be taken into account insofar as it is relevant:

(i) Lowry bought 320 million ordinary shares in Moran on 1 August 2018, when the other equity reserves of Moran were €20 million and the retained earnings of Moran were €132 million. The consideration was agreed at €800 million. This was satisfied by the issue of 200 million equity shares by Lowry at an agreed fair valuation of €750 million, plus €50 million to be paid by Lowry on 31 July 2019 if the profit target for the year (€15 million) was met by Moran. The contingent element of the consideration was recorded at its fair value of €38 million at 1 August 2018. As it turned out, significant losses were incurred by Moran in the year to 31 July 2019. Consequently, nothing is payable by Lowry on 31 July 2019 under this part of the deal. No entry has been made by Lowry to reflect this change in expectation.

(ii) The group accounting policy is to value any Non-Controlling Interests (NCI) at their fair value at the acquisition date. On the date, Lowry acquired its interest in Moran, the fair value of the NCI in Moran was €130 million.

(iii) At 1 August 2018, some equipment held by Moran had a fair value €25 million in excess of its carrying value. This equipment had a remaining useful economic life of 5 years at that date.

(iv) Lowry bought a 30% holding in the ordinary shares of Lucas on 1 August 2018, when the other equity reserves of Lucas were €75 million and the retained earnings balance in Lucas' books stood at €60 million. The consideration consisted of an immediate cash payment of €112 million. Lowry exerts significant influence over Lucas as a result of this shareholding. Other investments are held by all three companies. These are equity investments and not more than 5% of the issued share capital is held in any of these individual entities.

(v) During the financial year ended 31 July 2019, Moran sold goods to Lowry for €30 million. These goods were sold at a mark-up on cost of 100%. Of these goods, 40% of these goods remained in the inventory of Lowry at 31 July 2019: €2.5 million of the cost of these goods remains unpaid by Lowry at 31 July 2019.

(vi) No dividends were paid or proposed in the year by any of the companies.

(vii) Due to the unexpected losses incurred by Moran during the year, an impairment review was undertaken on 31 July 2019 and goodwill was found to be impaired by 60% of its acquisition value. There was no impairment necessary in respect of the investment in Lucas.

Note: *All workings should be rounded to the nearest €0.1m.*

REQUIREMENT:

(a) Prepare the Consolidated Statement of Financial Position for the Lowry group as at 31 July 2019 in accordance with International Financial Reporting Standards.

(24 marks)

(b) IFRS 3 - *Business Combinations* permits two methods for valuing non-controlling interest at acquisition. Discuss how the initial calculation and subsequent treatment of goodwill arising on the acquisition of Moran would have differed had the non-controlling interest been measured using the proportionate share of the identifiable net assets at the acquisition date. Recalculate the goodwill on this basis.

(6 marks)

[Total: 30 Marks]

2. The Trial Balance for Hubert Plc, as at 31 July 2019, is shown below:

Hubert Plc: Trial Balance as on 31 July 2019	**Note**	**DR € million**	**CR € million**
Revenue	(i)		1,200
Cost of Sales		790	
Distribution costs		86	
Administration expenses		259	
Land & Buildings at valuation	(ii)	750	
Accumulated depreciation at 1 August 2018 - buildings	(ii)		60
Plant & equipment at cost	(iii)	475	
Accumulated depreciation at 1 August 2018 - plant & equipment	(iii)		175
Intangible assets at cost	(iv)	100	
Financial assets	(v)	260	
Inventory at 31 August 2019		140	
Trade receivables		194	
Cash at bank		20	
Trade payables			244
Equity shares of €1 each			500
Share premium account			400
Revaluation surplus			40
Retained earnings reserve			344
Investment income			22
Equity investment reserve	(v)		71
Provision for warranty costs	(vi)		18
		3,074	3,074

The following notes are to be taken into account insofar as they are relevant:

(i) Revenue includes €40 million of goods sold to various customers on a sale or return basis. These goods are not yet paid for. Payment is due only if the customer sells on the goods before 31 October 2019. If this is not the case, they are to be returned to Hubert Plc undamaged. The average mark-up on these goods is 25% of cost.

(ii) Land and buildings were last revalued on 1 August 2014, when the land was valued at €150 million, and the buildings at €600 million. A loss of €50 million was charged to profit or loss in respect of the land as a result of that revaluation. A further revaluation exercise took place on 31 July 2019, resulting in a value of €180 million for the land and €580 million for the buildings. Land and buildings are treated as a single asset for the purpose of revaluations. The existing revaluation surplus on the trial balance relates solely to plant and equipment. No revaluation of plant or equipment was deemed necessary during the current year. The company treats depreciation as a charge to cost of sales. Hubert Plc has not yet charged depreciation for the year to 31 July 2019.

(iii) Hubert Plc depreciates plant and equipment at 20%, using the reducing balance basis.

(iv) The intangible assets on the trial balance comprise several ongoing projects, some of which were launched on the market during the year. These represent €30 million of the total balance. Hubert Plc wishes to amortise these over 5 years on a straight line basis, applying a full year's charge in the current year. Further development costs of €12 million are included in administration expenses. These meet the criteria for capitalisation as an intangible asset. No amortisation should be charged except as indicated above.

(v) The financial assets represent equity investments. These had a fair value of €310 million at 31 July 2019, which has not yet been incorporated into the financial statements. Hubert Plc has made an irrevocable election to take all fair value gains and losses on equity investments to "other comprehensive income" as permitted by IFRS 9 - *Financial Instruments.*

(vi) Hubert Plc offers a 12-month warranty on all goods sold to retail customers and maintains a provision for the expected cost of honouring this warranty. At 31 July 2019, Hubert has estimated the cost of honouring this warranty over the next 12 months to be €23 million. All costs are expected to be incurred within 12 months.

(vii) The corporation tax charge for the year has been estimated at €29 million. Ignore the taxation effects of any adjustments you make.

REQUIREMENT:
Prepare the following for Hubert Plc:

(a) The Statement of Profit or Loss and Other Comprehensive Income for year ended 31 July 2019. (13 marks)

(b) The Statement of Changes in Equity for year ended 31 July 2019. (4 marks)

(c) The Statement of Financial Position as at 31 July 2019. (13 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 in the answer sheet provided. [Total: 20 marks]

1. Which of the following is an 'enhancing' (as opposed to a 'fundamental') qualitative characteristic of financial information, as identified by the IASB's Conceptual Framework?

(a) Accruals
(b) Relevance
(c) Faithful representation
(d) Timeliness.

2. Which of the following statements is likely to be true if the current ratio for an entity is 0.9:1?

(i) Current assets are greater than current liabilities.
(ii) The entity is in danger of being unable to meet its current liabilities as they fall due.

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

3. The following information was extracted from the financial statements of Robert Plc for the year ended 31 July 2019:

	€
Opening Property Plant & Equipment (PPE)	4,500
Closing PPE	3,500
Disposal proceeds of PPE	680
Loss on disposal of PPE	890
Depreciation for year	1,100

Based on the information above, how much cash was paid to purchase new PPE during the year ended 31 July 2019?

(a) €2,350
(b) €1,670
(c) €2,560
(d) None of the above.

4. IAS 23 - *Borrowing Costs* sets out the conditions under which such costs should be capitalised or expensed. On 1 August 2018, Malcock Plc commenced construction of a factory building for its own use. On the same date it issued a 5% debenture for €40 million. The entire proceeds of the bond were used immediately to pay for the land and to purchase building materials for the project. Construction work commenced on 1 October 2018 and continued throughout the year, except for a half-month break at Christmas 2018 and a further half-month break in July 2019.

Which of the following amounts should be capitalised as borrowing costs under IAS 23?

(a) €2,000,000
(b) €1,833,333
(c) €1,666,667
(d) €1,500,000.

5. Larry Plc's reporting date is 31 July each year. The company has traditionally reported under Irish GAAP. Its directors wish to present their annual report for year ended 31 July 2019 under IFRS as permitted by Irish regulations.

   What is Larry Plc's 'transition date' to IFRS under IFRS 1 - *First Time Adoption of IFRS*?

(a) 31 July 2019
(b) 1 August 2018
(c) 31 July 2018
(d) 1 August 2017.

6. IFRS 8 - *Operating Segments* requires certain entities to disclose information on a segmental basis. Which of the following is true regarding IFRS 8?
   (i) All entities applying IFRS accounting standards are required to comply with IFRS 8.
   (ii) All segments of a business applying IFRS 8 must be reported on.

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

7. Nangle Plc (Nangle) entered into a 10-year lease on 1 August 2018 under which it agreed to make annual payments of €12 million in arrears in return for the use of a building. Nangle will not own the asset at the end of the lease period. The present value of the minimum lease payments was €80.52 million at 1 August 2018, and the useful economic life of the building was 50 years. Nangle's cost of capital is 8%.

   How much should be charged to Profit or Loss as finance costs for year ended 31 July 2019 under IFRS 16 *Leases*?

(a) €6.44 million
(b) €12.0 million
(c) Zero
(d) None of the above.

8. Mealiffe Plc is an Irish company whose functional currency is the euro (€). On 31 May 2019, it sold goods to a UK customer at an agreed price of GBP £40,000. At the reporting date 31 July 2019, the balance remained payable. The relevant exchange rates were as follows:

31 May 2019:	€1 = GBP £0.98
31 July 2019:	€1 = GBP £0.93

   Ignoring the time value of money, what is the amount of exchange gain or loss that would appear in the financial statements of Mealiffe Plc for year ended 31 July 2019 based on the above transaction?

(a) €2,195 loss
(b) €2,195 gain
(c) €3,011 loss
(d) €3,011 gain.

[Total: 20 marks]

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

4. IFRS 9 - *Financial Instruments* sets out the principles and rules for the appropriate accounting treatment of most financial instruments. In particular, it deals with loans between entities, both from the perspective of the lender and the borrower.

Tamsin Plc invests in bonds. Sometimes, it trades these bonds by flipping them quickly for profit. Others are held for the long term.

Details of two particular bonds purchased on 1 August 2018 are as follows:

	'Athy'	**'Rathangan'**
Nominal value of bond	€45 million	€30 million
Coupon interest rate	4%	5%
Purchase price of bond	€38.5 million	€28 million
Effective yield to maturity	6.75%	7.8%

The 'Athy' bond was purchased with a view to holding it for the long term, drawing the interest and principal as it becomes payable.

The 'Rathangan' bond was bought at a deep discount, and the aim is to wait until the market value increases, and then sell it on at a profit. At 31 July 2019, the 'Rathangan' bond had a fair value of €27.5 million.

In both cases, the coupon is payable on 31 July each year, and has been paid as promised.

REQUIREMENT:

(a) Discuss the accounting treatment required by IFRS 9 for recognition and measurement of financial assets such as bonds, paying particular attention to the tests required to decide between alternative treatments.

(10 marks)

(b) In the case of each bond above, outline the accounting treatment required by IFRS 9 for year ended 31 July 2019. Show all workings clearly.

(10 marks)

[Total: 20 Marks]

<u>OR</u>

5. IAS 38 - *Intangible Assets* sets out the principles of accounting for the recognition and measurement of intangible assets. The standard differentiates between intangible assets acquired individually, those acquired as part of a business combination, and those which are internally generated.

Charlie Plc (Charlie) has entered into the following transactions during the financial year ended 31 July 2019:

(i) On 1 August 2018 Charlie acquired the exclusive Irish distribution rights for a unique home entertainment digital set-top box. The cost of the rights to Charlie was €2.1 million, and the term of the deal was 3 years.

(ii) On 1 August 2018 Charlie commenced work on promoting the brand and developing sales of the product referred to in (i) above. This effort was hugely successful, and the "Charlie" brand became massively popular and well known. Charlie wishes to include the brand in its financial statements for year ended 31 July 2019 at its estimated fair value of €12 million.

(iii) Charlie wishes to replicate its Irish success in other countries by selling the product into other markets. The company has spent €500,000 during the year researching the UK market and wishes to capitalise this expenditure as an intangible asset.

REQUIREMENT:

(a) Discuss the requirements of IAS 38 with respect to the initial recognition and measurement of intangible assets acquired (1) separately for cash, (2) as part of a business combination, and (3) internally generated.

(9 marks)

(b) In each of the scenarios (i) to (iii) above, outline the appropriate accounting treatment for the year ended 31 July 2019. Parts (i) and (ii) carry 4 marks each, and part (iii) carries 3 marks.

(11 marks)

[Total: 20 Marks]

END OF PAPER

SUGGESTED SOLUTIONS

THE INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS IN IRELAND

CORPORATE REPORTING

PROFESSIONAL 1 EXAMINATION – AUGUST 2019

SOLUTION 1

Marking Scheme:

(a)	Basic consolidation (100% Lowry + 100% Moran)	3
	Calculation and treatment of goodwill (including NCI at acquisition date)	3
	Subsequent treatment of contingent consideration	1
	Investment in associate calculation and subsequent movement	2
	Fair value adjustments and post acq movements	2
	Intra group sales of inventory	2
	Elimination of intra-group receivables and payables	2
	Reserves calculation and consolidation - both	5
	NCI calculation at reporting date	2
	Presentation	2
	Subtotal	24
(b)	Explanation of alternative method permitted under IFRS 3	2
	Recalculation of goodwill	2
	Explanation of subsequent treatment of impairment losses	2
	Subtotal	6
	Total	**30**

SUGGESTED SOLUTION

(a) Group structure:
Lowry has 80% (controlling) equity in Moran, bought 12 months prior to the reporting date
Lowry has 30% equity in Lucas, bought 12 months prior to the reporting date.
Lucas is presumed to be an associate as shareholding is between 20% and 50%

Lowry Plc: Consolidated statement of financial position as at 31 July 2019

		€ million
Non current assets:		
Property, plant and equipment	(758+326 +20 (W5)	1,104.0
Goodwill	W1	136.4
Investment in Associate	W4	116.5
Investments	(1,200+40-750-38-112)	340.0
		1,696.9
Current assets:		
Inventories	(235+153 -6 (W7))	382.0
Trade receivables	(188+134 -2.5 (W8)	319.5
Cash & bank	(100+36)	136.0
		837.5
Total assets		**2,534.4**
Equity:		
Equity shares		1,000.0
Other equity reserves	W2 (b)	209.5
Retained earnings	W2 (a)	829.5
		2,039.0
Non-controlling interest	W3	84.9
		2,123.9

Current liabilities:			
Trade payables	(161+127 -2.5 (W8)		285.5
Contingent consideration	W6		0.0
Dividends proposed			80.0
Current taxation	(25+20)		45.0
			410.5
Total equity & liabilities			**2,534.4**

W1 - Goodwill on acquisition of Moran

		€ million
Cost of investment:		
Equity issued by Lowry		750.0
Contingent (W6)		38.0
788.0		
Value of NCI at acquisition (ii)		130.0
Fair value of net assets at acquisition		
Equity share capital	400	
Other equity reserves	20	
Retained earnings (see note below)	132	
Fair value adjustment (W5)	25	(577.0)
Goodwill		341.0
impairment loss (60% * 341)		(204.6)
Balance to SOFP		136.4

W2 (a) Retained earnings	**Lowry**	**Moran**
	€ million	**€ million**
Balance at reporting date	977.0	112.0
less balance at acquisition		(132.0)
goodwill impairment (iv)		(204.6)
Depreciation on fair value adjustment (W5)	(5.0)	
Elimination of contingent consideration (W6)	38.0	
Share of R/E of Associate (W4)	3.0	
Unrealised profit on intra-group trading	(0.0)	(6.0)
Subtotals	1018	-235.6
Consolidate Moran (80% * -235.6)	(188.5)	
Balance to SOFP	829.5	

W2 (b) Other equity reserves	**Lowry**	**Moran**
	€ million	**€ million**
Balance at reporting date	200.0	30.0
less balance at acquisition		(20.0)
Share of other equity of associate (W4)	1.5	0.0
Balance to SOFP		10.0
Consolidate Moran (80% * 10)	8	
Balance to SOFP	209.5	

W3 - Non-controlling Interest		**Moran**
		€ million
Balance at acquisition (W1)		130.0
Share of other equity reserves of Moran	(20% * 10)	2.0
Share of retained earnings of Moran	(20% * -235.6)	(47.1)
Balance to SOFP		84.9

W4 - Investment in Associate		**Lucas**
		€ million
Balance at acquisition (iv)		112.0
Share of post-acquisition equity reserves	(80-75) * 30%	1.5
Share of post-acquisition earnings	(70-60) * 30%	3.0
Balance to SOFP		116.5

W5 - Fair value adjustment		**€ million**
Balance at acquisition	to goodwill working	25.0
Depreciation since acquisition	25 / 5 years * 1 yr to R/E	(5.0)
Balance at reporting date	to PPE in SOFP	20.0

W6 - Contingent consideration		**€ million**
Agreed amount of contingent consideration	50.0	
Fair value at acquisition date	Include in goodwill calc.	38.0
Fair value at reporting date	Include in SOFP	0.0
Adjustment to retained earnings as gain		38.0

W7 - Intra-group trading		**€ million**
Total profit on trade	30 * 100/200	15.0
Proportion relating to goods still in group inventory at R/D		40%
Unrealised profit	Deduct from R/E of seller Deduct from group inventory	6.0

W8 - Intra-group balances outstanding	**€ million**
Balance owed from Moran to Lowry at reporting date	2.5
Eliminate this by reducing trade receivables and trade payables.	

(b) When the proportionate share of identifiable net assets is used to measure the non-controlling interests, goodwill will normally be somewhat lower than when using the fair value method. This is because the fair value method assigns some value for goodwill to the NCI, whereas the proportionate method does not.

The subsequent treatment of goodwill also differs when there is an impairment loss to be recognised. Under the fair value method, the impairment loss is allocated to the parent and the NCI in their profit-sharing ratio (normally in proportion to their equity holdings). Under the proportionate method, as no goodwill is assigned to the NCI, no part of the impairment loss is allocated to NCI. It is entirely allocated against the parent's share of profits.

Had the proportionate method been used in this question, the calculation of goodwill would be as follows (changes in bold):

W1 recalculated: - Goodwill on acquisition of Moran		**€ million**
Cost of investment:		
Equity issued by Lowry		750.0
Contingent (W6)		38.0
		788.0
Value of NCI at acquisition (20% * 577)		**115.4**
Fair value of net assets at acquisition		
Equity share capital	400	
Other equity reserves	20	
Retained earnings (see note below)	132	
Fair value adjustment (W5)	25	(577.0)
Goodwill		**326.4**
impairment loss (60% * 326.4)		**(195.8)**
Balance to SOFP		**130.6**

SOLUTION 2:

Marking scheme:

(a)	Statement of Profit or Loss and Other Comprehensive Income	
	Transfer of figures from trial balance to appropriate headings	2
	Removal of sale-or-return goods from revenue and cost of sales	2
	Depreciation on buildings (calculation and inclusion in cost of sales expenses)	1
	Depreciation on plant & equipment	1
	Amortisation of intangibles	1
	Revaluation of land & buildings (calculation and appropriate treatment)	2
	Capitalisation of intangible cost (and exclusion from admin expenses)	1
	Adjustment to warranty provision	1
	Tax (recognition in P/L)	0.5
	Presentation of gain on remeasurement of equity investments within OCI	1
	Presentation	0.5
	Subtotal	13
(b)	Statement of Changes in Equity	
	Opening balances	1
	Transfer of figures from SPLOCI to correct reserves	3
	Subtotal	4
(c)	Statement of Financial Position	
	Transfer of figures from trial balance to appropriate headings	2
	Land & buildings	2
	Plant & equipment	1
	Intangible assets	2
	Financial assets (calculation and recognition in NCA)	1
	Goods on sale or return added to inventory	1
	Goods on sale or return eliminated from receivables	1
	Transfer of figures from SOCIE to reserves	1
	Tax (recognition as liability)	0.5
	Warranty provision (calculation and inclusion of correct amount in liabilities)	1
	Presentation	0.5
	Subtotal	13
	Total	**30**

SUGGESTED SOLUTION

(a) Hubert Plc: Statement of Profit or Loss and Other Comprehensive Income for year ended 31 July 2019

		€ million
Revenue	(1,200 - 40) (W1)	1,160.0
Cost of Sales	(790 - 32(W1) +15 (W2) + 60 (W3) +6 (W4)	(839.0)
Gross profit		321.0
Distribution costs		(86.0)
Administration expenses	(259 - 12) (W4)	(247.0)
Investment income		22.0
Increase in provision for warranty costs	W6	(5.0)
Gain on revaluation of land & buildings	W2	50.0
Profit before tax		55.0
Tax	W7	(29.0)
Profit for the year		26.0
<u>Other comprehensive income (items that will not be recognised in profit or loss):</u>		
Gain on revaluation of land & buildings	W2	35.0
Gain on revaluation of equity investments	W5	50.0
Other comprehensive income for the year		85.0
Total comprehensive income for the year		111.0

(b) Hubert Plc Statement of Changes in Equity for year ended 31 July 2019

	Share Capital € million	Share Premium € million	Revaluation Surplus € million	Equity Investments € million	Retained Earnings € million	Total Equity € million
Balance 1 April 2017	500.0	400.0	40.0	71.0	344.0	1355.0
Profit for the year	0.0	0.0	35.0	50.0	26.0	111.0
Balance 31 March 2018	500.0	400.0	75.0	121.0	370.0	1466.0

(c) Hubert Plc Statement of Financial Position as at 31 July 2019

		€ million
Non-current assets:		
Land & buildings,	(750 +10) - (60+15 - 75) (W2)	760.0
Plant & equipment	475 - (175 + 60) (W3)	240.0
Intangible assets	(100 - 6 + 12) W4	106.0
Financial assets	(260 + 50) (W5)	310.0
		1,416.0
Current assets:		
Inventory	(140 + 32 (W1))	172.0
Trade receivables	(194 - 40 (W1))	154.0
Cash & bank		20.0
		346.0
Total assets:		**1,762.0**
Equity:		
Equity share capital	(b)	500.0
Share premium	(b)	400.0
Revaluation surplus	(b)	75.0
Equity investment reserve	(b)	121.0
Retained earnings	(b)	370.0
		1,466.0
Current liabilities:		
Trade payables		244.0
Provision for warranty costs	(18 + 5) W6)	23.0
Corporation tax due	W7	29.0
		296.0
Total equity & liabilities		**1,762.0**

Workings:

W1 – Revenue

This item should not be included in revenue. Goods cannot be considered sold until the risks and rewards associated with them have been transferred to the new owner. The unconditional right to return the goods ensures that substantial risks remain with the seller.

We must:

(a) exclude the goods from revenue;
(b) exclude the amount receivable from trade receivables; and
(c) include the goods within closing inventory at cost price.

	€ million	€ million
Dr Revenue	40	
Cr Trade receivables		40
Dr Inventory (40 *25/125)	32	
Cr Cost of Sales		32

W2 – Land & Buildings
Depreciation must be charged for the year based on old values as the revaluation does not take place until the end of the year.
The existing accumulated depreciation is the total amount charged from 1 August 2014 until 1 August 2018 (as the accumulated depreciation is always made zero on a revaluation). Hence the annual depreciation can be assumed to be €15 million (60m / 4years).

	€ million	€ million
Dr Cost of Sales	15	
Cr Accumulated depreciation – Land & buildings		15

The revaluation must account for the difference between the carrying value and the fair value at the revaluation date. The carrying value must take account of any depreciation not yet recorded up to that date. Hence:

	Land € million	Buildings € million
Fair value 31 July 2019	180	580
Carrying value (buildings: 600 – 60 – 15)	(150)	(525)
Revaluation surplus	30	55

The revaluation surplus should first of all reverse previous revaluation losses taken to profit or loss. As these were entirely relating to land, there is no depreciation adjustment. Also, as land and buildings are considered to be a single asset, there is no requirement to split the revaluation gain between both parts. Hence €50 million is credited to profit or loss (and will increase retained earnings). The remainder of the surplus is taken to other comprehensive income, and on to the revaluation surplus reserve.

As always, the asset account is updated to reflect the new valuation (increase from 750 to 760), and the accumulated depreciation account is eliminated (60 plus the current year's charge of 15).

	€ million	€ million
Dr Land & buildings	10	
Dr Accumulated depreciation – Land & buildings	75	
Cr Profit or loss		50
Cr Other comprehensive income		35

W3 – Plant & equipment
Depreciation for year
The charge for depreciation is to be 20% of the reducing balance.
This works out at 20% * (475 – 175) = 60

	€ million	€ million
Dr Cost of Sales	60	
Cr Accumulated depreciation – plant & equipment		60

W4 – Intangible assets
Amortisation
€30 million should be amortised over 5 years commencing this year. €6 million per year. Cost of sales may be used, but as there is no clear policy in place, other headings are acceptable also.

Hence:

	€ million	€ million
Dr Cost of Sales	6	
Cr Accumulated amortisation – intangible assets		6

Further capitalisation
If the €12 million meets the IAS 38 criteria for capitalisation, they should not be includd in administration expenses. They should be included within intangible assets.

Hence:

	€ million	€ million
Dr Intangible assets	12	
Cr Administration expenses		12

W5 – Financial assets

Under IFRS 9, equity investments should be classified as "Fair Value" financial instruments, and remeasured to fair value at each reporting date. Any resulting gains or losses are taken to profit or loss unless the entity makes an irrevocable election to take them to OCI. This election has been made by Lowry, hence the gain in value of €50 million (310-260) should be taken to OCI as well as being reflected in the carrying value of the equity investments. This gain is also reflected in the equity investment reserve.

Hence:

	€ million	€ million
Dr Other comprehensive income	50	
Cr Financial assets		50

W6 – Warranty provision

The current liability needs to be updated at each reporting date to reflect the best estimate of the cost of honouring the promise made (present obligation).

As the existing provision is recorded at €18 million, an additional charge of €5 million must be made, bringing the provision up to €23 million. This should be charged to profit or loss and added to the existing provision. Administration costs could be used for this; a separate heading is acceptable either.

As all costs are expected to be incurred within 12 months, the provision should be classified as a current liability.

Hence:

	€ million	€ million
Dr Profit or loss	5	
Cr Provision for warranty costs		5

W7 – Tax liability

The estimate should be incorporated into the financial statements.

Hence:

	€ million	€ million
Dr Profit or loss (taxation)	29	
Cr Current liability (tax payable)		29

SOLUTION 3

Each correct mark gains 2.5 marks. No partial marks are awarded. Workings are not marked.

1 **Answer (d)**

Accruals is not a qualitative characteristic, and both answers (b) and (c) are fundamental.

2. **Answer (b)**

A ratio of 0.9:1 suggests that current assets are less than current liabilities. Hence statement (i) is false.

It is generally advised that an entity should have current assets in excess of its current liabilities so that there is a comfortable level of expected short term cash inflow (current assets) to meet expected short term cash outflows (current liabilities). It follows that if current assets are below current liabilities then there is a risk of the entity being unable to meet its short term outflows. Hence statement (ii) is true.

3. **Answer (b)**

The calculation is as follows:

Opening property plant & equipment (PPE)	€4,500
Disposal of PPE at carrying value (680 + 890)	(1,570)
Depreciation for year	(1,100)
Purchased (balancing figure)	1,670
Closing PPE	€3,500

4. **Answer (d)**

Under IAS 23, borrowing costs should be capitalised when three conditions are met:

(i) Borrowing costs are being incurred;
(ii) Expenditure is being incurred; and
(iii) Activities are taking place to construct the asset.

Here, (i) and (ii) are taking place all year. Construction activities were not taking place for August and September 2018, and for 1 month during the breaks. Hence there was 9 months activity, and 9/12 of the interest cost should be capitalised.

5% * €40 million * 9/12 = €1.5 million

5. **Answer (d)**

Under IFRS 1 the transition date is the beginning of the comparative period.

6. **Answer (d)**

Only entities that have their equity or debt traded in public markets are required to apply IFRS 8. Hence statement (i) is false.

IFRS 8 distinguishes between operating segments and reportable segments. Only reportable segments, not all segments, are required to be reported on. Hence statement (ii) is false.

7. **Answer (a)**

Under IFRS 16, all leases are capitalised at the present value of their minimum cash flows. The discount rate is applies to this balance to amortise it over time. Hence for the full year ended 31 July 2019, finance cost at 8% of €80.52 million should be charged.

8. **Answer (b)**

The trade receivable is initially recorded at the rate ruling at the transaction date:
£40,000 / 0.98 = €40,816

At the reporting date, the amount outstanding (all of it in this case) is remeasured at the year-end rate.
£40,000 / 0.93 - €43,011

The difference of €2,195 is a gain, as the euro amount receivable has increased.

SOLUTION 4

Marking Scheme:

(a)	5 correct points, including the two tests, at 2 marks each	10
(b)	Accounting treatment for two bonds at 5 marks each	10
Total		20

Suggested solution:

(a) Classification of financial assets

There are three sub-classifications used for financial assets. These are:

- Amortised cost;
- Fair value through profit or loss; or
- Fair value through other comprehensive income.

Amortised cost is used for an asset if BOTH the following two tests are satisfied:

(1) Cash Flow Test - The contractual cash flows are solely payments of principal and interest on the principal amount outstanding; AND
(2) Business Model Test - the asset is being held with the intention of drawing the contractually agreed cash flows for its life,

If BOTH tests are met, then the amortised cost classification is required. Otherwise (if EITHER one fails) fair value should be used. This normally applies to debt instruments expected to be held to maturity.

Fair value through other comprehensive income is used for a debt asset if BOTH the following two tests are satisfied:

(1) Cash Flow Test - The contractual cash flows are solely payments of principal and interest on the principal amount outstanding; AND
(2) Business Model Test - the asset is being held within a business model which seeks to both collect contractual cash flows and sell financial assets.

Fair value through profit or loss is used for all other debt instruments.

<u>Subsequent measurement of financial assets</u>
Financial assets are remeasured at each reporting date in accordance with the classification method adopted.

Amortised Cost:
- If classified as "amortised cost", the effective interest rate method is applied in arriving at an updated valuation at each reporting date. Amortised cost is the amount at which a financial asset or liability is measured at initial recognition, plus or minus the cumulative amortization (using the effective interest rate) of any difference between the initially recognized amount and the maturity amount, allowing for any payments in the intervening period.

- The effective interest rate is that rate that exactly discounts the estimated future cash payments or receipts for the life of the instrument to the net carrying value of the instrument.

Fair Value:
- If classified as "fair value", the asset or liability is revalued to fair value at each reporting date. Gains and losses are normally taken to profit or loss but there are important exceptions:

    - An irrevocable election was made (in the case of an equity investment not held for trading) to take fair value gains and losses to OCI;
    - The asset is a debt instrument required to be carried at fair value through other comprehensive income due to the business model adopted;

Fair value not capable of reliable measurement:
If the fair value of a financial asset is not capable of reliable measurement (rare), the asset or liability should be measured at cost.

(10 marks)

(b) Athy

As the bond was purchased with a view to holding it for the long term, the business model test is met. As the bond's cash flows consist solely of interest and principal payments, the cash flow test is met. Hence, this bond should be accounted for using the amortised cost method.

The bond is recorded at its cost, plus any costs to purchase (not relevant here).

	€ million	**€ million**
Dr Financial assets	38.5	
Cr Cash		38.5

Subsequently, the effective yield to maturity should be used to amortise the bond over the year. This is applied to the opening balance to determine the finance cost (6.75% * 38.5m = 2.59875 million or €2.6 million)

	€ million	**€ million**
Dr Financial assets	2.6	
Cr Profit or loss (finance income)		2.6

Finally, the interest payment was paid at 31 July 2019 as promised. This should be 4% of the par value €45 million, or €1.8 million. This is treated as a reduction to the financial asset.

	€ million	**€ million**
Dr Cash	1.8	
Cr Financial assets		1.8

(5 marks)

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As this bond was purchased with a view to sell it on, the business model test fails. Hence, amortised cost cannot be used to measure the bond. It must be remeasured to fair value at the reporting date.

The bond is recorded at cost, but any costs of purchase would be expenses in this scenario.

	€ million	**€ million**
Dr Financial asset	28	
Cr Cash		28

At 31 July 2019, the scheduled interest is paid, at 5% of par value €30 million, or €1.5 million. This is taken to finance income.

	€ million	**€ million**
Dr Cash	1.5	
Cr Finance Income		1.5

Finally, at the reporting date, the bond is remeasured to fair value, €27.5 million. This shows a loss of €0.5 million which should be taken to profit or loss.

	€ million	**€ million**
Dr Profit or loss (finance costs)	0.5	
Cr Financial Assets		0.5

(5 marks)

[Total: 20 MARKS]

SOLUTION 5

Suggested solution:

(a) Recognition

An intangible asset should be recognised if:

- It is probable that economic benefits associated with the asset will flow to the entity.
- The cost / value of the asset can be measured reliably

If these criteria are not met, the relevant expenditure should be expensed. It is prohibited to reinstate any intangible asset originally charged to expenses.

Recognition and Measurement

- Purchased separately
    - o If the asset was purchased separately, recognise as an intangible at cost provided it meets the definition above.
    - o If the asset is acquired for free or nominal sum by way of government grant eg radio licence, it may be recognised at fair value (under IAS 20 government grants). If this option is not taken, it must be recognised at cost including directly attributable expenditure.

- Purchased as part of a group of assets (e.g. takeover of a business)
    - o If purchased as part of a business, capitalise at fair value if it can be reliably measured on initial recognition. If not, include with goodwill.
    - o The cost of assets acquired under an exchange is measured as the value of the asset given up in return.

- Internally generated
    - o Internally generated goodwill should never be recognised.
    - o Internally generated intangibles other than goodwill may not be recognised unless there is an active market in identical assets allowing a fair value to be attributed to the asset. Most internally generated assets will not meet this rule.
    - o One exception to the above rule is the issue of development costs (NOT research). These should be capitalised if the following criteria are met:

- Probable that product being developed will generate future economic benefits

- Intention to complete and use / sell

- Resources are available to complete project

- Ability to use / sell

- Technical feasibility of the product being developed

- Expenditure can be measured reliably.
    - o Computer software should generally be capitalised at cost, but operating systems should be included with the hardware cost within PPE, not within intangibles.
    - o Any expenditure initially written off as an expense may not be retrospectively capitalised under any circumstances. However, an intangible asset written off due to changes in circumstances may be reinstated if those circumstances reverse.

(9 marks)

(b)

(i) This is an intangible asset, acquired as a separate asset for cash consideration.
This should be capitalised at cost, €2.1 million.
The asset should be amortised over its useful economic life, in this case 3 years.
Amortisation to be charged in the year ended 31 July 2019 is €0.7 million.

	€ million	**€ million**
Dr Intangible asset	2.1	
Cr Cash		2.1

	€ million	€ million
Dr Profit or loss	0.7	
Cr Accumulated amortisation – intangible asset		0.7

(4 marks)

(ii) The Charlie brand falls into the category of an internally generated intangible asset.

Under IAS 38, internally generated assets cannot be recognised unless they can be valued by reference to an active market in identical assets. Clearly every brand is unique, so there cannot, by definition, be an active market in identical assets. Similar, maybe, but identical, no.

The other exception to the non-recognition rule is the instance of development costs. The development of a brand does not meet the criteria for capitalising development costs.

Hence, the costs of developing the brand must be expensed, and the fair value of the brand may not be recognised under IAS 38.

(4 marks)

(iii) This expenditure falls into the category of market research.
IAS 38 specifically precludes the capitalisation of market research.
Hence the €500,000 must be expensed as incurred. (3 marks)

[Total: 20 MARKS]