CPA IRELAND | CERTIFIED PUBLIC ACCOUNTANTS

CORPORATE REPORTING

PROFESSIONAL 1 EXAMINATION - APRIL 2016

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.

Note: You have optional use of the Extended Trial Balance, which if used, must be included in the answer booklet.

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.

1. Acoff Plc (Acoff) is a public limited company based in Ireland. It has shareholdings in two other companies, Braggs Plc (Braggs) and Van Cleff Plc (Van Cleff). Van Cleff is based in Switzerland and uses the Swiss Franc (CHF) as its functional currency. Statements of financial position are shown below for all three companies as at 31 March 2016.

Statements of Financial Position as at 31 March 2016

	Acoff Plc € million	**Braggs Plc € million**	**Van Cleff Plc CHF million**
Non-current assets			
Property, plant & equipment	750	223	80
Investments (including group companies)	460	76	
	1,210	299	80
Current assets			
Inventories	310	42	13
Trade receivables	122	75	17
Cash & bank	64	15	8
	496	132	38
Total assets	**1,706**	**431**	**118**
Equity			
Equity share capital of €1 / CHF1 each	400	100	50
Retained earnings	987	224	40
	1,387	324	90
Non-current liabilities			
10% Debenture Notes	200	60	
Current liabilities			
Trade payables	87	36	18
Current taxation	32	11	10
	119	47	28
Total equity & liabilities	**1,706**	**431**	**118**

The following additional information may be relevant:

(i) Acoff bought an 80% holding in the equity shares in Braggs on 1 April 2014, when the retained earnings of Braggs were €180 million. The consideration was agreed at €250 million for these shares. This amount was paid in cash. The "fair value" method is used by the group for calculating goodwill on all acquisitions. On 1 April 2014, the fair value of the non-controlling interest in Braggs was independently assessed at €58 million.

(ii) Acoff bought a 90% holding in the equity shares of Van Cleff on 1 April 2015, when the retained earnings balance in Van Cleff's books stood at CHF31.2 million. The consideration consisted of an immediate cash payment of CHF84 million. Van Cleff operates as an autonomous entity, although subject to managerial control by the directors of Acoff. The fair value of the non-controlling interest in Van Cleff at 1 April 2015 was CHF9 million.

(iii) On 1 April 2014, certain patents formed part of the net assets of Braggs, but were not recognised in its entity financial statements. These had a fair value of €20 million at the date of acquisition by Acoff. These patents were due to expire 8 years after the date of acquisition by Acoff.

(iv) During the financial year ended 31 March 2016, Acoff sold goods to Braggs amounting to €20 million. The transfer price included a profit margin of 20%. Of these goods, 75% remained in the closing inventory of Braggs at the reporting date. All these goods had been paid for at the reporting date.

(v) No dividends were paid or proposed in the year by any group company.

(vi) Acoff exercised the option permitted under IAS 27 *Separate Financial Statements* to carry all investments in subsidiaries and associates at cost in its individual financial statements. All other investments are carried under IFRS 9 *Financial Instruments*, and are correctly measured at the reporting date.

(vii) Goodwill was reviewed for impairment at each reporting date, and no losses were considered to have been suffered since acquisition.

(viii) All workings may be rounded to the nearest €0.1m.

(ix) Relevant exchange rates were as follows:

o	1 April 2015	€1 = CHF 1.2
o	31 March 2016	€1 = CHF 1.05
o	Average for year ended 31 March 2016	€1 = CHF 1.15

REQUIREMENT:

(a) Prepare the Consolidated Statement of Financial Position for the Acoff group as at 31 March 2016 in accordance with International Financial Reporting Standards. (23 marks)

Format & Presentation (1 mark)

(b) Explain and quantify how the initial calculation and subsequent treatment of goodwill on the acquisition of Braggs would have differed had the consolidated statement of financial position been prepared under FRS 100-102. You are not required to redraft the statement in answer to this requirement.

(6 marks)

[Total: 30 MARKS]

2. Kenny Plc is a public listed manufacturer. Its summarised consolidated financial statements for the year ended 31 March 2016 (with 2015 comparatives) are as follows:

Kenny Plc:
Consolidated Statements of Profit or Loss and Other Comprehensive Income for year ended 31 March.

	2016 € million	2015 € million
Revenue	18,410	16,200
Cost of sales	(15,200)	(11,100)
Gross profit	3,210	5,100
Operating costs	(3,750)	(3,600)
Gains on revaluation of financial assets	20	40
Finance costs	(49)	(33)
Profit (loss) before taxation	(569)	1,507
Income tax expense	(80)	(180)
Profit for the year	**(649)**	**1,327**
Profit for the year attributable to:		
Owners of the parent	(654)	1,327
Non-controlling interests	5	-
Profit for the year	**(649)**	**1,327**

Kenny Plc: Consolidated Statements of Financial Position as at 31 March:

	2016 € million	2015 € million
Non-current assets:		
Property, plant and equipment	2,360	2,400
Intangible assets	350	350
Goodwill	60	0
Financial assets	210	180
	2,980	2,930
Current assets:		
Inventory	400	275
Trade receivables	460	340
Bank		230
	860	845
Total assets	**3,840**	**3,775**
Equity:		
Equity shares of €1 each	1,400	1,300
Share premium	500	350
Retained earnings	504	1,205
	2,404	2,855
Non-controlling interest	50	0
	2,454	2,855
Non-current liabilities:		
6% Bonds 2021	680	550
Current liabilities:		
Trade payables and provisions	466	280
Bank overdraft	160	---
Current tax payable	80	90
	706	370
Total equity and liabilities	**3,840**	**3,775**

The following notes should be taken into account, if relevant:

(i) On 1 April 2015, Kenny bought an 80% stake in another entity, Lenny Plc. The cost of this stake was €200 million, satisfied by Kenny issuing 48 million equity shares valued at €2.50 each and €80 million in cash.

The fair value of the net assets acquired on the acquisition date was €180 million, consisting of the following:

• Property, plant & equipment	€120m
• Intangible assets	€30m
• Inventory	€25m
• Cash	€20m
• Trade payables	(€15m)
	€180m

The fair value of the non-controlling interest at the acquisition date was €47 million. Kenny Plc uses the full goodwill method in all acquisitions. Goodwill was impairment tested at 31 March 2016, and any impairment loss was correctly accounted for through operating expenses.

(ii) There were no disposals of non-current assets during the period. No intangible assets were acquired apart from those acquired through the acquisition of Lenny Plc. Depreciation of property, plant & equipment amounted to €207 million, charged to operating expenses. Amortisation of intangible assets was also charged to operating expenses.

(iii) There were no non-cash adjustments to the 6% Bonds.

(iv) Included in the figure for "trade payables and provisions" at 31 March 2016 is a provision for warranty claims amounting to €27 million (2015: €14 million).

(v) Equity dividends were paid during the period by Kenny and Lenny.

(vi) Financial assets which had cost €60 million, and had a carrying value on 31 March 2015 of €75 million, were sold during the year for €78 million.

REQUIREMENT:

(a) Prepare a Consolidated Statement of Cash Flows for the Kenny group in accordance with IAS 7 - *Statement of Cash Flows*.

(19 marks)

Format & Presentation (1 mark)

(b) Evaluate, using suitable ratios where relevant, any insights revealed by the statement of cash flows into the financial performance and position of the group as at 31 March 2016. (10 marks)

[Total: 30 MARKS]

3. **The following multiple-choice question contains eight sections, each of which is followed by a choice of answers. Only one answer is correct in each case. 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.

1. On 1 April 2015, Ratzinger Plc held a property at a carrying value of €3 million. The buildings element of the property (25% of the total value) had a remaining useful economic life of 10 years. On 1 October 2015, Ratzinger Plc decided to sell the property, as it no longer needed it. On that date the property met all the IFRS 5 *Non-Current Assets held for Sale and Discontinued Operations* criteria for classification as "held for sale". The estimated fair value less costs to sell was €3.25 million at 1 October 2015 and at the reporting date 31 March 2016. Depreciation is charged on a straight line basis and time apportioned as appropriate.

   What is the correct carrying value at 31 March 2016?

   (a) €3,250,000
   (b) €3,000,000
   (c) €2,962,500
   (d) €2,850,000

2. IAS 41 *Agriculture* applies to which of the following assets?

   (a) Seeds awaiting planting
   (b) Land used for growing trees
   (c) Trees growing in a forest
   (d) Lumber harvested and awaiting processing

3. Each of the following events occurred after the reporting date but prior to the date of approval of the financial statements.

   Which of the following should be treated as an adjusting event under IAS 10 *Events After the Reporting Period*?

   (a) An earthquake caused €5 million of uninsured damage.
   (b) A customer went bankrupt owing the company €5 million in trade receivables.
   (c) A customer was injured on a company premises, and filed a lawsuit for €5 million.
   (d) None of the above.

4. On 1 April 2015, Egvern Plc borrowed €15 million in order to fund the construction of a new building. The interest rate was 6% payable annually in arrears. On 1 July 2015, construction commenced. On 1 October 2015, the due date, €10 million was paid to the contractor as the first stage payment. On 1 December 2015, a further €10 million was paid to the contractor. Construction was still in progress at the reporting date of 31 March 2016. Unused funds were used for general corporate purposes until needed to fund the construction.

   Which of the following amounts should be capitalised under IAS 23 *Borrowing Costs*?

   (a) €900,000
   (b) €600,000
   (c) €450,000
   (d) €400,000

5. Berger Plc invested in a bond on 1 April 2015, at a cost of €40 million. The costs of purchase were €2 million. The nominal and maturity value of the bond was €50 million, and the coupon interest rate was 2% annually in arrears. The maturity date was 31 March 2020, giving an effective yield to maturity of 5.775%.

   What should be the carrying value of the bond at the reporting date of 31 March 2016 under the amortised cost method of IFRS 9 *Financial Instruments*, assuming the interest was paid as scheduled?

   (a) €43.4255 million
   (b) €41.31 million
   (c) €43.6255 million
   (d) €42 million

6. Under IFRS 11 *Joint Arrangements* which of the following is true?

   (a) All joint arrangements must be accounted for using the equity method.
   (b) There must be two and only two parties to an arrangement before it may be classed as a joint arrangement.
   (c) There are two types of joint arrangement: joint operation and joint venture.
   (d) All joint arrangements must be separate legal entities.

7. The following statements relate to the required accounting treatment of investment properties under the fair value model of IAS 40 *Investment Property*.

   (i) Investment properties are not depreciated.
   (ii) Investment properties must be revalued to fair value at each reporting date.
   (iii) Gains and losses on revaluation of investment properties are recognised in profit or loss.

   Which of the above statements are true?

   (a) (i) and (ii) only
   (b) (ii) and (iii) only
   (c) (i) and (iii) only
   (d) (i), (ii) and (iii)

8. Under IAS 32 *Financial Instruments – Presentation* which of the following is FALSE?

   (a) All financial instruments are either assets, liabilities or equity.
   (b) All financial instruments have two counterparties.
   (c) Financial liabilities are financial instruments that create an obligation on the part of one counterparty to transfer cash to the other counterparty.
   (d) Shares that usually earn a dividend are classified as financial liabilities in the books of the issuing entity.

[Total: 20 MARKS]

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

4. IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance* sets out the requirements for recognising as income any grants received from government agencies, together with any repayments of such grants.

On 1 January 2014, Gilmartin Plc (Gilmartin) applied to a government agency for a grant to assist with the construction of a factory in Portlaoise. The proposed construction cost of the factory was €52 million and the company projected that 350 people would be employed on its completion. The land was already owned by Gilmartin.

On 1 March 2014, the government agency offered to grant a sum amounting to 25% of the factory's construction cost to a maximum of €13 million. The grant aid was to be payable on completion, and would be repayable on demand if total employment at the factory fell below 300 people within 5 years of completion.

At the financial year end, 31 March 2014, Gilmartin had accepted the offer of grant aid, and had signed contracts for the construction of the factory at a total cost of €52 million. Construction work was due to commence on 1 April 2014.

By 31 March 2015, the factory had been completed on budget, 400 people were employed ready to commence manufacturing activities, and the government agency agreed that the conditions necessary for the drawdown of the grant had been met.

On 1 April 2015, the factory was brought into use. It was estimated that it would have a ten-year useful economic life. On 1 June 2015, the government agency paid over the agreed €13 million. In addition, the company sought and was paid an employment grant of €1.2 million as employment exceeded original projections. This is expected to be payable annually for 5 years in total, at a rate of €12,000 per additional person employed over 300 in each year. There are no repayment provisions attached to the employment grant. The directors of Gilmartin expect employment levels to exceed 350 people for at least 4 further years from 31 March 2016.

REQUIREMENT:

(a) Detail the requirements of IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance* with respect to government grants to aid capital expenditure. Your answer should cover the initial recognition and subsequent treatment of these grants.

(7 marks)

(b) Discuss, showing calculations and journal entries where relevant, how Gilmartin Plc should record the above transactions and events in its financial statements for years ended 31 March 2014, 2015 and 2016.

(10 marks)

(c) Advise what accounting adjustments which would be necessary should it become apparent at 31 March 2017, that employment at the factory would soon drop below 300 people.

(3 marks)

[Total: 20 MARKS]

OR

5.

(a) 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. IAS 38 relies on the concept of fair value to measure intangibles, but the strength of the fair value test varies depending on the objective.

Handsetter Plc (Handsetter) has entered into the following transactions during the financial year ended 31 March 2016. The company seeks to maximise the reported value of its assets wherever possible.

(i) On 1 April 2015, Handsetter acquired, from a bankrupt competitor, a licence to provide radio broadcast services to a region within Ireland. This licence would have been originally issued by the government for a ten-year period at zero cost, but has a market value due to its exclusivity. The cost of the licence to Handsetter was €3.3 million, and the remaining useful economic life was 6 years.

(ii) On 1 April 2015, Handsetter commenced work on developing a new technology to enhance the quality of the radio broadcasts. It purchased a number of patents at a cost of €2 million and spent a further €6 million developing the technology, as well as €2 million researching the international market for the technology in advance of its launch. The directors of Handsetter were confident throughout the development process that the technology had massive potential to generate future economic benefit. On 31 March 2016, this opinion was validated when a rival broadcaster offered Handsetter €15 million for its partially developed technology project.

(iii) As a result of Handsetter's growing reputation in the broadcasting industry, the directors commissioned a consulting firm to value its brand name. The brand name has not been recognised as an asset in the financial statements to date. On 31 March 2016, the consultants issued a report stating that the fair value of Handsetter's brand was €20 million.

(iv) Handsetter has a portfolio of patents it developed over the past few years. These represent technologies and processes used in the company's business to generate economic benefits. The total carrying value of these patents was €2.8 million at 1 April 2015. They originally had a 15-year useful economic life, but on average seven years remain to their expiry date. The directors propose, at 31 March 2016, to revalue this portfolio to its estimated fair value of €5 million.

REQUIREMENT:

(a) Discuss the requirements of IAS 38 *Intangible Assets* 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 (iv) above, prepare a briefing not for Handsetter's financial controller advising on the appropriate accounting treatment for the intangible assets for year ended 31 March 2016. (11 marks)

[Total: 20 MARKS]

END OF PAPER

SUGGESTED SOLUTIONS

THE INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS IN IRELAND

CORPORATE REPORTING

PROFESSIONAL 1 EXAMINATION – APRIL 2016

SOLUTION 1

Marking Scheme:

(a)	Basic consolidation (100% Acoff + 100% Braggs + 100% Van Cleff translated)	3
	Goodwill and translation thereof (including NCI at acquisition date)	4
	Translation of Van Cleff's SOFP	5
	Fair value adjustments and post acq movements	2
	Intra group sales of inventory	2
	Reserves calculation and consolidation – retained earnings and translation	5
	NCI calculation at reporting date	2
	Presentation	1
	Subtotal	**24**
(b)	Explanation of differences between IFRS and FRS 100-102 in relation to goodwill	2
	Calculation of goodwill at acquisition under FRS 100-102	2
	Calculation of impairment losses and carrying value	2
	Subtotal	**6**

[Total: 30 Marks]

Suggested solution

(a)
Group structure:
Acoff has owned 80% of Braggs for 2 years. This gives control therefore Braggs is a subsidiary.
Acoff has owned 90% of Van Cleff for the full year therefore Van Cleff is a subsidiary.
Van Cleff's financial statements are denominated in Swiss Francs, hence it needs to be "translated" into euro prior to consolidation.

Acoff Group plc: Consolidated Statement of Financial Position as at 31 March 2016

[Plan = 100% Acoff + 100% Braggs + 100% Van Cleff as translated]	**€ million**
Non current assets:	
Property, plant and equipment (750 + 223 + 76.2 (W5))	1,049.2
Goodwill (8 + 11.2) (W1)	19.2
Intangible assets (W6)	15.0
Other investments (460 + 76 – 250 - 70) exclude group investments (W1)	216.0
	1,299.4
Current assets:	
Inventories (310 + 42 + 12.4 (W5) – 3 (W6))	361.4
Trade receivables (122 + 75 +16.2 (W5))	213.2
Cash & bank (64 + 15 + 7.6 (W5))	86.6
	661.2
Total assets	**1,960.6**
Equity:	
Equity shares	400.0
Retained earnings (W2)	1,022.1
Translation reserve (W3)	10.6
	1,432.7
Non-controlling interest (W4)	75.2
	1,507.9
Non-current liabilities:	
10% debenture notes (200 + 60	260.0
Current liabilities:	
Trade payables (87 +36 + 17.1 (W5))	140.1
Current taxation (32 + 11 + 9.5 (W5))	52.5
	192.6
Total equity & liabilities	**1,960.6**

W1
Calculation of goodwill on acquisition of:

	Braggs		**Van Cleff**		
	€ million	**€ million**	**CHF million**	**Rate**	**€ million**
Consideration					
Cash		250	84	1.2	70.0
Value of NCI		58	9	1.2	7.5
FV of identifiable net assets acquired					
Equity share capital	100		(50.0)	1.2	(41.7)
Pre-acquisition reserves	180		(31.2)	1.2	(26.0)
FVA – Patents	20	300			
Goodwill at acquisition		8	11.8	1.2	9.8
Exchange gain (loss) (balancing figure – to translation reserve)					1.4
Goodwill 31 March 2016			11.8	1.05	11.2

Tutorial note:
Goodwill on the acquisition of Van Cleff is considered an asset of that entity. As it is not included in its SOFP (and hence not translated as part of that step) it needs to be translated separately. The treatment of the gain or loss on translation depends on the method used to calculate goodwill in the first place. If full fair value method is used (as is the case here), the gain is attributed to the parent and the NCI in proportion to their ownership interests.

If goodwill were calculated under the partial method, this means only the parent's portion of goodwill is recognised. Hence any exchange gain or loss on goodwill would be attributable to the parent only. This is the same principle that applies to goodwill impairment losses.

W2

Group retained earnings at 31 July 2015	**Acoff € million**	**Braggs € million**	**Van Cleff € million**
Balance per SOFP (total at y/e)	987	224	33.65
Less balance at acquisition (note (i))		(180)	(26.00)
Amortisation of FVA Patent (W6)		(5)	
Elimination of unrealised profit in inventory (W7)	(3)		
Adjusted reserves for consolidation	984	39	7.65
Consolidate Braggs to group (80% * 39)	31.2		
Consolidate Van Cleff to group (90% * 7.65)	6.9		
Group total	1,022.1		

W3

Group translation reserve at 31 July 2015	**Acoff € million**	**Braggs € million**	**Van Cleff € million**
Balance per translated SOFP (W5)			10.4
Exchange gain on translation of goodwill (W1)			1.4
Total			11.8
Consolidate to group SOFP (90% * 11.8)	10.6		

[Consolidate to NCI (10% * 11.8) = 1.2]

W4

Non-controlling interest at 31 July 2015	**Braggs € million**	**Van Cleff € million**
Balance at acquisition (from W1)	58	7.5
Share of post-acquisition retained earnings from W2		
Braggs: 20% * 39	7.8	
Van Cleff: 10% * 7.65		0.8
Share of post-acquisition translation reserve from W3		1.2
Consolidated total €75.3 million	65.8	9.5

W5

Translation of Van Cleff's SOFP			**CHF million**	**Rate**	**€ million**
Non-current assets:					
Property, plant & equipment			80	1.05	76.19
			80		76.19
Current assets:					
Inventories			13	1.05	12.38
Trade receivables			17	1.05	16.19
Cash & bank			8	1.05	7.62
			38		36.19
Total assets			**118**		**112.38**
Equity:					
Equity share capital of €1 / CHF1 each			50	1.2	41.67
Retained earnings:	Pre-acquisition	31.2		1.2	26.00
	Post-acquisition	8.8	40	1.15	7.65
Translation reserve (balancing figure)					10.40
			90		85.72
Current liabilities:					
Trade payables			18	1.05	17.14
Current taxation			10	1.05	9.52
Total liabilities			28		26.66
Total equity & liabilities			**118**		**112.38**

Tutorial Note:
Assets and liabilities are translated at the closing rate, pre-acquisition equity at the rate ruling at the acquisition date, and post acquisition equity at the rate ruling when earned. The balancing figure in all of this represents the currency gain (or loss) earned (or suffered) during the period between the acquisition or earning of the net assets, and the reporting date.

W6

Fair value adjustments (note (iv)):

	At acquisition	**Movement**	**At rep. date**
Patents Braggs	€20m	(€5m)**	€15m

**Movement = cumulative amortisation of the patents since acquisition: €20m / 8 yrs * 2 yrs = €5m. This is charged to the earnings of the company which holds (and therefore depreciates) the asset, namely Braggs. Hence in the group accounts:

Dr Intangible assets	€15.0m	
Dr Retained earnings – Braggs	€5.0m	
Cr Goodwill (FV net assets)		€20.0m

Tutorial Note:
IAS 38 may require certain intangible assets not to be recognised (appear) in entity financial statements. This is usually because they were internally generated and did not meet the criteria for recognition at the time. This does not necessarily mean they have no value. It is not uncommon for assets with an economic value not to be recognised in the financial statements under IFRS.

In a takeover situation, if a fair value is assignable to these assets, they are required to be recognised in the group financial statements at their fair value. This recognises the fact that the acquirer has accorded these assets value in deciding how much to pay for the entity. If this value is not allocated to the intangible asset, it will be subsumed into goodwill. This does not change their accounting treatment in the individual books of the entity, merely in the group financial statements.

W7

Intra-group trading of goods

Unrealised profit (URP) on goods held in closing inventory:		
(€20m * 20/100) * 75% (sold by Acoff therefore NCI IS NOT affected)		€3.0m
Adjustment to reduce reserves (Acoff) and Inventory:		
Dr Retained earnings (Acoff)	€3.0m	
Cr Inventory		€3.0m

(b) Under FRS 100-102 goodwill is calculated under the partial method only. Also, there is no annual impairment review. Instead a 10 year useful economic life is assumed and goodwill is amortised over this period.

Hence, in relation to Braggs, the goodwill calculation would be as follows:

		€ million
Cost of Investment		250
Value of NCI (20% * 300)		60
Fair value of identifiable net assets acquired:		
Equity share capital	100	
Retained earnings	180	
FVA – patent	20	
		(300)
Goodwill at acquisition		10
Amortisation for year ended 31 March 2015		(1)
Amortisation for year ended 31 March 2016-01-23		(1)
Carrying value 31 March 2016		8

SOLUTION 1

Marking Scheme:

(a) Statement of cash flows

Start with profit before taxation	1
Deduct gains on revaluation of financial assets	1
Deal with finance costs (twice)	1
Depreciation on PPE (add back)	1
Calculate and add back goodwill impairment	1
Calculate and add back amortisation of intangibles	1
Calculate movement of working capital items	4
Calculate taxation paid, and deduct	1
Calculation and deduction of payments to acquire subsidiary	1
Calculation and deduction of payments to acquire PPE	2
Calculation and deduction of payments to acquire financial assets	1
Calculation and addition of proceeds of loan note	1
Calculation and addition of proceeds of share issue	1
Calculation and deduction of equity dividends	1
Calculation and deduction of dividend payments to NCI	1
Presentation	1
Subtotal	**20**

(b) Discussion and analysis

Maximum of 4 marks for calculation of ratios. Analysis should focus on the SOCF, but may refer to other statements in support. Candidates scoring 7-10 marks should be displaying particularly insightful analysis.

Any 10 valid points / ratios for 1 mark each	10
Subtotal	**10**

[Total: 30 Marks]

Suggested solution

(a) Kenny plc: Statement of Cash Flows for year ended 31 March 2016

	€ million	€ million
Operating Activities		
Profit before taxation		(569)
Gains on revaluation of financial assets	(20)	
Finance costs	49	
Goodwill impairment charge	7	
Depreciation of PPE (W1)	207	
Amortisation of intangibles (W2)	30	
Movement in inventory (400 – (275 + 25))	(100)	
Movement in trade receivables (460 – 340)	(120)	
Movement in trade payables [(466-27) – (280-14+15)]	158	
Movement in provision for warranty claims (27-14)	13	
	224	
Finance costs paid	(49)	
Taxation paid (W7)	(90)	85
Net cash flow from operating activities		(484)
Investing Activities		
Cash paid to acquire subsidiary (W8)	(60)	
Cash paid to acquire PPE (W1)	(47)	
Cash paid to acquire financial assets (W4)	(10)	
Net cash flow from investing activities		(117)
Financing Activities		
Issue of 6% bonds	130	
Proceeds of equity share issue (W5: 52+78)	130	
Equity dividends paid (W5)	(47)	
Dividend paid to non-controlling shareholders (W5)	(2)	
Net cash flow from financing activities		211
Net cash flow for the year		(390)
Opening cash & cash equivalents		230
Closing cash & cash equivalents		(160)

W1

PPE

	€ million		€ million
Bal b/d	2,400	Depreciation (note ii)	207
Acquired on acq. of Lenny plc (W8)	120		
Acquired for cash (balancing figure)	47	Bal c/d	2,360
	2,567		2,567

W2

Intangible Assets

	€ million		€ million
Bal b/d	350	Impairment charge (bal fig)	30
Acquired on acq. of Lenny plc (W8)	30	Bal c/d	350
	380		380

W3

Goodwill

	€ million		**€ million**
Bal b/d	--	Impairment charge (bal fig)	7
Recognised on acq. of Lenny plc (W8)	67	Bal c/d	60
	67		67

W4

Financial Assets

	€ million		**€ million**
Bal b/d	180		
Profit or loss	20	Bal c/d	210
Acquired for cash (bal fig)	10		
	210		210

W5 – Equity Reconciliation

Share Cap.	**Share Prem.**	**R/E**	**NCI**	
€ million	**€ million**	**€ million**	**€ million**	
Opening Balance	1,300	350	1,205	0
Profit for year			(654)	5
Issued for acq. (W8)	48	72		
Arising on acq. (W8)				47
Shares issued cash	52	78		
Dividend paid to NCI				(2)
Equity dividends paid			(47)	
Closing balance	1,400	500	504	50

W6

6% Bond

	€ million		**€ million**
		Bal b/d	550
Bal c/d	680	Cash (bal fig)	130
	680		680

W7

Taxation

	€ million		**€ million**
Cash paid (balancing figure)	90	Bal b/d	90
Bal c/d	80	SPLOCI	80
	170		170

W8 – Acquisition€ million

Cost of investment (80%)		
Shares issued (48 share capital, 72 share premium)	120	
Cash	80	
	200	
FV of NCI	47	
FV of net assets at acquisition:		
PPE	120	
Intangible assets	30	
Inventory	25	
Cash	20	
Trade payables	(15)	
		(180)
Goodwill		67

Net cash flow impact on purchase is an outflow of €60m (cash paid 80m less cash acquired 20m).
All other implications should be recorded in the respective accounts.

(b) Discussion and analysis of statement of cash flows

Relevant points might include the following:

- The company has lost a significant sum of money during the period. This is clear from the statement of profit or loss. In addition, the company's operating cash flow is deeply negative. This is unsustainable and urgent action is necessary.
- Investment continued during the year, shown by the outflow in this section. However investment in property, plant & equipment was lower than depreciation, again suggesting this was insufficient to sustain operating capacity into the long term.
- The cash deficit was offset to a large extent by the issue of new equity shares and loan notes. Again, this is unlikely to be sustainable into the future, as the willingness of investors to lend or purchase equity is dependent on expectations of profit.
- It is questionable whether the payment of an equity dividend was advisable given the losses and cash deficit for the year. Whilst the entity has sufficient accumulated profits to legally pay a dividend, it makes little sense to incur the costs of raising new equity and simultaneously return significant sums to equity holders through dividends.
- Liquidity ratios are tightening, increasing the urgency of finding a solution to the problem. The current ratio has reduced from 2.28 to 1.22. Inventory, receivables and payables days have all disimproved, but not seriously. The main cause of the deterioration in liquidity is the cash deficit.
- The company has significant potential sources of cash to see it through a period of repair. Financial assets could be sold, and working capital could be much more tightly managed. However this fiscal space could burn up very quickly if current losses continue.

Advanced points might include the following:

- It is clear that the losses have not been caused by the acquisition. In fact, it is clear that the acquired company made a profit. This is evidenced by the portion of the profit for the year attributable to the non-controlling interest. The fact that this is positive implies that the subsidiary made a profit.
- Revenue has increased by €2.2bn whilst gross profit declined by €1.9bn. This suggests that the main cause of the drop in profits is the reduced gross margin (from 31% to 17%). The causes of this should be investigated urgently. Possible causes are (1) excessive price discounting to win market share, (2) cost increases not passed on to customers through higher prices, (3) mismanagement of inventory or cash.

Ratio calculations:

	2016	**2015**
Gross margin	3,210 / 18,410 = 17%	5,100 / 16,200 = 31%
Current ratio	860 / 706 = 1.22:1	845 / 370 = 2.28:1
Inventory days	400/15,200*365 = 9.61	275 / 11,100 *365 = 9.04
Receivables days	460/18,410 * 365 = 9.12	340/16,200*365 = 7.66
Payables days	(466-27)/15,200*365 = 10.54	(280-14)/11,100*365 = 8.75

SOLUTION 3

Marking scheme:

Each correct mark gains 2.5 marks. No partial marks are awarded. Workings are not marked. **[Total: 20 Marks]**

Suggested solution:

1 **Answer (c)**

On 1 October, the date the IFRS 5 criteria were met to carry the property as "held for sale", 6 month's depreciation should have been charged. The depreciation amount should be €3,000,000 * 25% * 6/12 = €37,500. This brings the carrying value to €2,962,500 (€3,000,000 – 37,500). The carrying value on transfer to "held for sale" should be the LOWER of the carrying value immediately before transfer or its fair value less costs to sell.

2. **Answer (c)**

IAS 41 defines agricultural assets as those actually growing. Seeds awaiting planting and products harvested are inventory items under IAS 2. Land is an IAS 16 asset.

3. **Answer (b)**

IAS 10 specifically requires the bankruptcy of a customer to be considered an adjusting event. The presumption is that the conditions leading to the bankruptcy existed at the reporting date.

4. **Answer (d)**

IAS 23 requires that three conditions be met before capitalisation of finance costs takes place. These are (1) finance costs are being incurred; (2) activities necessary to bring the asset into use are under way; and (3) expenditure has been incurred. On this basis all three are met only on the payment of the first €10 million to the contractor on 1 October 2015. The finance cost on this amount from 1 October 2015 to 31 March 2016 should be capitalised (€10m * 6% * 6/12), amounting to €300,000.

On 1 December 2015 a further €10 million was paid to the contractor. However only €5 million of this was borrowed. Hence (€5m * 6% * 4/12) €100,000 should be capitalised.

5. **Answer (a)**

The carrying value of the bond is calculated as follows:

	€ million
Cost (including costs of purchase)	42
Finance cost for year (42 * 5.775%)	2.4255
Coupon payment (€50m * 2%)	(1)
Closing carrying amount	43.4255

6. **Answer (c)**

(a) Is incorrect as a joint operation is accounted for by each party individually dealing with its portion of assets, liabilities, income and expenses.
(b) Is incorrect as a joint arrangement is not limited to two venturers under IFRS 11.
(c) IS correct.
(d) There is no requirement that a joint arrangement be a separate legal entity. A joint venture must be a separate entity, but a joint operation may or may not be.

7. Answer (d)

All three statements are true under the fair value model of IAS 40.

8. Answer (d)

Shares are classified as debt or equity depending on the obligations attaching to them. If a dividend is compulsory it is likely that the instrument is a liability. However a regularly paid dividend, especially on an equity share, is not normally compulsory. Hence such shares would be classified as equity.

SOLUTION 4

Marking Scheme:

(a)	Answer should cover the two options for initially recognition of capital grants, netting against the cost of the asset acquired, and the setting up of a deferred income account. Subsequent treatment should detail the amortisation of the grant to income, and any repayment potential.	
	Subtotal	**7**
(b)	2014 accounting implications	2
	2015 accounting implications	4
	2016 accounting implications	4
	Subtotal	**10**
(c)	Three relevant points at 1 mark each	**3**
		[Total: 20 Marks]

Suggested solution:

(a) Grants in respect of capital expenditure are to be recognised within income as the related assets are expensed to income. This normally happens through depreciation or sale.

On receipt of a capital grant, there are two options open to an entity under IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*.

First, the grant may be credited to the asset account in respect of which the grant is received. This has the effect of lowering the carrying value of the asset, with a consequential reduction of any depreciation charge. This has the effect of benefiting the profit for the accounting periods in which the asset is used. This method is primarily a legacy of the income-statement driven approach to accounting. The Conceptual Framework currently in issue is financial position driven. Showing an asset at a cost net of grants would conflict with the framework.

The second allowable method is the deferred income approach. Under this method a capital grant is credited to a separate account on receipt. This account is held as a liability, and amortised over the period expected to benefit from the asset's use. The asset is kept at its cost less depreciation. The net effect on the profit or loss is the same as under method 1, but the balances in the statement of financial position are more likely to reflect the true asset values. As such, this method is more aligned with the philosophy of current accounting standards.

The deferred income balance should be reported as a current liability to the extent that it is expected to be recognised as income within a period of 12 months. It should be recognised as a non-current liability otherwise.

If an asset in respect of which a grant was received is subsequently sold, and there are no repayment implications as a result of the sale, any unamortised portion of the grant can be recognised immediately in income.

If there are repayment implications, provision should be made for repayment as a liability or disclosure as a contingent liability in accordance with the principles contained in IAS 37 Provisions, Contingent Liabilities and Contingent Assets.

Any unamortised balance in deferred income accounts should be used to provide for repayment if necessary. Once these are used up, a charge should be made to profit or loss.

(b) Year ended 31 March 2014:
No accounting entry is made in this financial year, as no transaction has yet been entered into. A capital commitment exists, and should be disclosed in the notes. The grant approval should be disclosed also.

Year ended 31 March 2015:
At this date, the factory should be recorded at its cost of €52 million. As all conditions for the payment of the grant have been met, recognition should be made of this amount receivable also. As the factory has not yet been brought into use, no depreciation will be charged for the year. Similarly, no amortisation of the grant will take place in the period.

Recognition of factory:

Dr Property, plant & equipment	€52 million	
Cr Cash		€52 million
(New factory constructed as a cost of €52 million)		

Recognition of grant:
Option 1

Dr Government grant receivable (current asset)	€13 million	
Cr Property, plant & equipment		€13 million
(Government grant approved, not received yet)		

Option 2

Dr Government grant receivable (current asset)	€13 million	
Cr Deferred income – current liability		€1.3 million
Cr Deferred income – non-current liability		€11.7 million
(Government grant approved, not received yet)		

Assuming the factory has a useful life of 10 years, as stated, 10% of the amount will be recognised as income within the next financial year. This amount should be treated as a current liability.

Year end 31 March 2016:
There are a number of transactions to record based on the new factory. These are (1) depreciation and (2) amortisation of the grant. In addition, the cash was received from the government agency.

Receipt of grant:

Dr Cash	€13 million	
Cr Government grant receivable		€13 million
(Receipt of cash grant from government agency)		

Option 1
Depreciation of factory:

Dr Profit or loss	€3.9 million	
Cr Accumulated Depreciation – PPE		€3.9 million
(Depreciation of cost of factory net of grant over 10 years)		

Option 2
Depreciation of factory:

Dr Profit or loss	€5.2 million	
Cr Accumulated Depreciation – PPE		€5.2 million
(Depreciation of gross factory cost over 10 years)		

Amortisation of grant:

Dr Deferred income	€1.3 million	
Cr Profit or loss		€1.3 million

(Amortisation of grant over 10 years, reflecting the proportional expensing of the factory to which the grant relates)

The employment grant relates entirely to the cost of employing staff in that year. Hence it should be entirely recognised as income in the year ended 31 March 2016.

Recognition of employment grant:

Dr Cash	€1.2 million	
Cr profit or loss		1.2 million
(recognition of employment grant as income as received)		

(10 marks)

(c) At this point it is becoming likely that the grant will be repayable, as employment levels are likely to drop below 300. Under the original grant, this condition creates a potential liability to repay the €13 million.

At 31 March 2017, an assessment must be made regarding the likelihood of repayment being necessary. If this is deemed probable, provision must be made for the cost of repayment.

If option 1 was used to account for the grant, the cost of the factory will be increased by the amount of the grant, and an increased amount of depreciation charged so that the cumulative depreciation charged since purchase is that which would have been charged had no grant been received.

If the second option was used, the amount of repayment will be charged to any deferred income balance in the first instance, and to profit or loss thereafter.

(3 marks)

[Total: 20 MARKS]

SOLUTION 5

Marking Scheme:

(a) 9 valid points at 1 mark each, with at least 2 from each of the three sections requested.
Subtotal 9

(b) 4 scenarios at 3 marks each to a maximum of
Subtotal 11

[Total: 20 Marks]

Suggested solution:

(a) An intangible asset is an identifiable non-monetary asset without physical substance.

The enterprise must have the ability to control the asset in order to obtain economic benefit from it. Examples include brand names, software, licences, franchises, copyrights, patents, customer lists, quotas, etc…

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.

Specific guidance for certain categories of intangible asset:

(1) Purchased separately
If the asset was purchased separately, recognise it as an intangible at cost provided it meets the definition above.
If the asset is acquired for free or nominal sum by way of government grant e.g. 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.

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

(3) Internally generated
Internally generated goodwill should never be recognised.
Internally generated intangibles other than goodwill may not be recognised unless there is an active market in homogeneous assets allowing a fair value to be attributed to the asset. Most internally generated assets will not meet this rule.

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.

Computer software should generally be capitalised at cost, but operating systems should be included with the hardware cost within PPE, not within intangibles.

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.

Amortisation of intangible assets
If intangibles are considered to have an indefinite useful economic life (UEL), they should not be amortised. If this is the case, an annual impairment review is required.

If UEL is not indefinite, amortise over the UEL using a method which best reflects the pattern of consumption of economic benefits. This period should be reviewed at least annually.

The amortisation charged should be expensed to profit or loss unless required to be capitalised by another standard.

Revaluation of intangibles
Intangibles may be revalued only if a market value is available. This means an active market exists in identical assets with public prices available.

The entity may choose to adopt the cost model under IAS 38, therefore never revaluing assets.

Treatment of revaluation gains and losses is similar to that of tangible non-current assets under IAS 16.

(9 marks)

(b)

(i) As the licence was acquired individually, it is capitalised at its cost. The licence should be depreciated over its useful economic life, here 6 years. Revaluation is unlikely to be permitted as each licence is likely to be unique. An active market in identical assets cannot exist for unique assets. Amortisation amount: €3.3 million / 6 years = €0.55 million per annum. (3 marks)

(ii) This intangible asset was partly purchased, and partly internally generated through enhancement expenditure.

The asset purchased should be capitalised at cost. This was €2 million. And further development costs should be capitalised only if they meet the IAS 38 criteria for capitalisation. It would appear that these criteria were met as the directors were confident of the potential of the technology since their original purchase. Hence, the €6 million spent developing the technology should be capitalised. The €2 million spent researching the international market may not be capitalised, and should be written off to profit or loss. The €15 million offer may not be recognised unless it is accepted. Revaluation of intangibles is only permitted by reference to an active market in identical assets. This asset is unique, hence whilst it may be valuable, it cannot be verified by reference to an active market. Therefore no revaluation is permitted. (3 marks)

(iii) The brand name is internally generated. Hence it may not be recognised unless it meets the IAS 38 criteria for recognising development projects as intangible assets. Brand names do not meet these criteria for several reasons:

(1) They do not constitute development costs;
(2) The expenditure to create the asset is not easily separable;
(3) It is not possible to demonstrate any certainty over the future economic benefit to be generated.

Hence, the brand should not be capitalised. (3 marks)

(iv) No revaluation is permitted, as no active market exists for identical patents. By definition, patents are unique and cannot have identical market matches.

The portfolio should be carried at cost less accumulated amortisation. Amortisation should be charged for year ended 31 March 2016 at 1/7 of €2.8 million, or €0.4 million. This should be taken to profit or loss unless it qualifies to be capitalised as part of a development project.

(3 marks)