CPA IRELAND | CERTIFIED PUBLIC ACCOUNTANTS

CORPORATE REPORTING

PROFESSIONAL 1 EXAMINATION - APRIL 2018

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.

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

1.

Statements of Financial Position as at 31 March 2018

	Angela Plc € million	Gerhard Plc € million	Helmut Plc € million
Non-current assets:			
Property, plant & equipment	2,300	600	100
Investments	1,500	50	5
	3,800	650	105
Current assets:			
Inventories	760	210	23
Trade receivables	440	150	13
Cash & bank	300	30	8
	1,500	390	44
Total assets	**5,300**	**1,040**	**149**
Equity:			
Equity share capital of €1 each	1,000	300	40
Share premium	500	100	20
Retained earnings:	2,750	500	61
	4,250	900	121
Current liabilities:			
Trade payables	570	80	18
Taxation	250	40	10
Dividends proposed	230	20	0
	1,050	140	28
Total equity & liabilities	**5,300**	**1,040**	**149**

The following additional information is provided:

(i) Angela Plc (Angela) bought 10 million shares in Helmut Plc (Helmut) on 1 April 2016, at a cost of €25 million paid in cash. On that date, the balance on the retained earnings reserve of Helmut stood at €37 million.

(ii) Angela bought 240 million shares in Gerhard Plc (Gerhard) on 1 October 2017. The consideration for the purchase was €950 million. Of this amount, €750 million was paid in cash on the date of purchase, and payment of the balance was deferred to 1 October 2018. The cash payment was recorded in the books of Angela, but no entry was made to record the deferred element of the purchase price. On 31 March 2017, the retained earnings reserve of Gerhard stood at €420 million. On 1 October 2017, the fair value of the non-controlling interest in Gerhard was €200 million. Angela wishes to use the fair value method of calculating goodwill for all acquisitions.

(iii) On 1 October 2017, the fair values of the net assets of Gerhard were equal to their carrying values with the exception of certain plant and equipment. This plant and equipment had a fair value €36 million in excess of the carrying value at that date. No adjustment has been made to reflect this difference. The plant and equipment had a 4 year remaining life at 1 October 2017.

(iv) At 31 March 2018, the goodwill of Gerhard was assessed for impairment, and it was agreed that an impairment loss of €8 million would be recognised.

(v) During the post-acquisition period, Angela bought goods from Gerhard for a total sum of €40 million. These goods cost Gerhard €35 million. 20% of the goods remained unsold by Angela at the reporting date.

(vi) At 31 March 2018, Angela had paid €2 million of the amount owing to Gerhard for goods purchased. The remainder was included in trade receivables of Gerhard and trade payables of Angela.

(vii) The dividends proposed by both companies were proposed at 31 March 2018. No dividend was paid by Gerhard during the financial year. Angela has not recognised its share of Gerhard's proposed dividend.

(viii) The cost of capital for Angela is 10% per annum. All profits are assumed to accrue evenly over the year.

All workings and solutions should be completed to the nearest €0.1 million.

REQUIREMENT:

(a) Prepare a Consolidated Statement of Financial Position for the Angela Group for year ended 31 March 2018 in accordance with IFRS.

(22 marks)

(b) Discuss the concepts and accounting treatment of 'deferred consideration' and 'contingent consideration' in the context of the acquisition of a subsidiary by a parent entity.

(8 marks)

[Total: 30 Marks]

2. Emmanuel Plc is a company involved in the provision of services to construction companies. Its trial balance as at ended 31 March 2018 is presented below:

Emmanuel Plc: Trial Balance as at 31 March 2018	**Note**	**Dr €m**	**Cr €m**
Revenue	(i)		450
Cost of Sales		160	
Distribution costs		25	
Administration expenses		185	
Land and Buildings at valuation	(ii)	200	
Accumulated depreciation 1 April 2017 - buildings	(ii)		20
Plant and equipment at cost	(ii)	170	
Accumulated depreciation 1 April 2017 - plant & equipment	(ii)		50
Intangible assets at cost	(iii)	80	
Financial assets	(iv)	64	
Inventory 31 March 2018		42	
Trade receivables		50	
Cash at bank		60	
Trade payables			30
Equity shares of €1 each			200
Share premium account			60
Revaluation surplus	(ii)		40
Retained earnings reserve			136
Equity investment reserve	(iv)		30
Provision for restoration costs	(v)		20
		1,036	1,036

The following additional information is provided:

(i) Revenue includes €10 million received as the agreed price from the sale of an item of plant and equipment. This item cost €30 million and had been depreciated by €24 million up to 1 April 2017. No other entry was made in respect of this transaction, except to record the amount of €10 million in cash and revenue.

(ii) The land and buildings figure represents the most recent valuation of €20 million for land and €180 million for buildings.

Administration expenses include the following items in connection with the construction of a new building by Emmanuel for its own corporate use:

• Construction materials	€18 million
• Direct labour provided by Emmanuel	€8 million
• Professional fees incurred	€1 million
• Management time and overhead apportionment	€1 million

A revaluation took place at 31 March 2018 revealing a valuation of €25 million for land and €210 million for buildings, including the new building referred to above.

Buildings are depreciated at a rate of 2% of cost or valuation, with a full year's charge in the year of acquisition and none in the year of disposal.

Plant and equipment is depreciated at 25% reducing balance, with a full year's charge in the year of acquisition and none in the year of disposal.

All depreciation and amortisation is charged to cost of sales expense.

(iii) Intangible assets represent intellectual property assets developed and capitalised under IAS 38 - *Intangible Assets.* It has been decided to commence amortising these assets in the current year, on a straight-line basis over their useful economic life of 13 years. In addition, there was €11 million charged to administration expenses in respect of the development of an additional patent, which was granted in 2017. This patent meets the IAS 38 - *Intangible Assets* criteria for capitalisation and should be amortised as per the terms stated above.

(iv) Financial assets consist of equity investments in respect of which the company has elected to recognise gains and losses in fair value within Other Comprehensive Income (OCI). Any such gains and losses are taken to a separate component of equity. On 31 March 2018, the fair value of the equity investments held was €58.5 million.

(v) A condition of the planning permission that was granted for the construction of one of the company's buildings was that the building be dismantled and the site restored at the end of its useful economic life. The estimated cost of this was capitalised and recorded as a provision at its present value at the date of construction. The balance for this provision, carried at €20 million, represents the carrying value at 1 April 2017. A discount rate of 5% was used in its initial measurement. The building has several years of economic life remaining.

(vi) The directors estimate that the corporation tax liability for the year will be €7.5 million.

All workings and solutions should be calculated to the nearest €0.1 million.

REQUIREMENT:
Prepare the following for Emmanuel Plc:

(a) A Statement of Profit or Loss and Other Comprehensive Income for year ended 31 March 2018. (12 marks)

(b) A Statement of Changes in Equity for year ended 31 March 2018. (5 marks)

(c) A Statement of Financial Position as at 31 March 2018. (13 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 be awarded for the correct answer except where you select more than one answer for any question.**

REQUIREMENT:
Give your answer to each section on the answer sheet provided

1. Which of the following is NOT an 'enhancing' qualitative characteristic of financial information as identified by the IASB's Conceptual Framework?

   (a) Prudence.
   (b) Understandability.
   (c) Comparability.
   (d) Timeliness.

2. Liam Ltd. has a current ratio of 2.3:1, and an acid test (quick) ratio of 1.5:1. Which of the following statements must be true regarding the financial position of Liam Ltd.?

   (a) There is sufficient cash in the bank to meet short-term needs.
   (b) Inventory is 0.8 times current liabilities.
   (c) The company is carrying too much inventory.
   (d) Inventory is 0.8 times current assets.

3. Liam Ltd. had a gross margin of 50% in 2017 as compared to 40% in 2016. Which of the following statements must be true regarding the performance of Liam Ltd.?

   (a) Sales revenue must have increased in 2017 over 2016.
   (b) If sales revenue remained the same in both years, cost of sales must have increased in 2017 from 2016.
   (c) If sales revenue decreased in 2017 over 2016, cost of sales must have decreased also.
   (d) None of the above is certain to be true.

4. Liam Ltd. has a return on capital employed (ROCE) of 8%, and a return on equity (ROE) of 12%. Assuming no taxation is incurred, which of the following statements must be true regarding the financial position of Liam Ltd.?

   (a) The company has no borrowings.
   (b) The cost of borrowing is less than or equal to 8%.
   (c) The cost of borrowing is greater than 8% but less than 12%.
   (d) The cost of borrowing is greater than or equal to 12%.

5. According to IAS 7 - *Statements of Cash Flow,* under which heading in the Statement of Cash Flows should cash payments to acquire property plant and equipment be included?

   (a) Cash Flows from Operating Activities.
   (b) Cash Flows from Investing Activities.
   (c) Cash Flows from Financing Activities.
   (d) None of the above.

6. At 31 March 2017, Fred Ltd carried a provision in its books for €3.2 million. This represented the expected cost of a restructuring announced earlier in March. This was communicated to all affected parties. During the year ended 31 March 2018, restructuring costs of €1.5 million were incurred and charged to administrative expenses. The estimate of costs remaining to complete the restructuring at 31 March 2018 was €1 million. What adjustment should be made at 31 March 2018 to reflect the current estimate?

(a) Debit provision and credit profit or loss with €2.2 million.
(b) Debit provision and credit profit or loss with €1.5 million.
(c) Debit provision and credit profit or loss with €1 million.
(d) Debit profit or loss and credit provision with €1 million.

7. Which of the following are biological assets, as defined by IAS 41 - *Agriculture*?

(a) Laboratory equipment.
(b) Agricultural equipment and machinery.
(c) Harvested agricultural produce.
(d) Agricultural crops prior to harvest.

8. According to IAS 33 - *Earnings per Share*, what is the theoretical ex-rights price of a share?

(a) The share's market price immediately before any rights issue.
(b) The price charged by a company for any new shares issued during a rights issue.
(c) The price at which shares are expected to trade following completion of a rights issue.
(d) The price at which a shares should trade, in the opinion of company management.

[Total: 20 marks]

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

4. IFRS 15 - *Revenue from Contracts with Customers* was issued in May 2014, and is effective for accounting periods beginning on or after 1 January 2018. However, early adoption is permitted. The IFRS requires a 5-step approach to determining the amount of revenue to be recognised by an entity.

(i) On 31 March 2018, Derek Plc signed a contract to supply 500 units of product at an agreed price of €1,000 per unit. 300 units were delivered at that date, with the remainder to be delivered on 1 June 2018. It was agreed that the customer would have extended credit terms of 12 months from the date of delivery. Derek Plc's cost of capital is 10%.

(ii) During the year ended 31 March 2018, Derek Plc took payment in advance for the supply of 2,000 hotel room-nights to customers at €100 per room per night. Only 400 of these had been occupied by 31 March 2018. The amounts paid by the customers are non-refundable unless the company fails to provide the agreed accommodation.

Assume Derek Plc has decided to adopt IFRS 15 for year ended 31 March 2018.

REQUIREMENT:

(a) Outline the general principles and the 5-step approach to recognising revenue as set out by IFRS 15 - *Revenue from Contracts with Customers*.

(10 marks)

(b) In each scenario above, calculate the amount of revenue to be recognised in the financial statements of Derek Plc for year ended 31 March 2018. Show the journal entries required to record each transaction. Justify your answer in each case.

(10 marks)

[Total: 20 Marks]

<u>OR</u>

5. IAS23 - *Borrowing Costs* sets out the conditions that must be met in order to capitalise borrowing costs incurred by entities purchasing or constructing non-current assets.

(i) Henry Plc commenced construction of a non-current asset on 1 June 2017. On 1 July 2017, it borrowed €5 million at an annual interest rate of 8% to finance the development. On 15 November 2017, the workers went on strike and no work was done until the dispute was settled on 15 December 2017. The project was still in progress at 31 March 2018. Interest was paid monthly in arrears.

(ii) Georgina Plc drew down a loan of €2 million on 1 April 2017 to part-finance the construction of a new building. The rate of interest applicable was 6% per annum. Building commenced on 1 April 2017, but no money was spent until 30 June 2017 when the construction company were paid their first instalment of €1.2m. The €2m borrowed was invested for 3 months (April – June) in government bonds carrying an annual interest rate of 2%. Once the construction company was paid, the remaining €0.8m was placed with a bank on deposit at a rate of 3% per annum. This was withdrawn on 30 September 2017 and spent on the development. The asset was completed on 30 November 2017.

REQUIREMENT:

(a) Discuss the conditions that must be met in order to capitalise borrowing costs under IAS 23 - *Borrowing Costs*. Your answer should set out when the capitalisation of borrowing costs should commence, be suspended, and cease.

(8 marks)

(b) In the case of (i) and (ii) above, recommend the accounting treatment as required by IAS 23. Show any journal entries necessary to record the transactions.

(12 marks)

[Total: 20 Marks]

END OF PAPER

SUGGESTED SOLUTIONS

THE INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS IN IRELAND

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PROFESSIONAL 1 EXAMINATION – APRIL 2018

Solution 1

(a) Group structure:
Angela has 80% (controlling) equity in Gerhard, bought 6 months prior to the reporting date. NCI 20%.
Angela has 25% equity in Helmut, bought 2 years ago. In accordance with IAS 28 it is presumed Helmut is an associate as between 20% and 50% of the voting equity is held by the parent.

Angela Plc: Consolidated statement of financial position of as at 31 March 2018

		€ million
Non-current assets:		
Property, plant and equipment	(2,300 + 600 + 31.5 (W5))	2,931.5
Goodwill	W1	227.8
Investment in Associate	W4	31.0
Financial Assets	(1,500 - 25 - 750 + 50)	775.0
		3,965.3
Current assets:		
Inventories	(760 + 210 – 1.0 (W7))	969.0
Trade receivables	(440 + 150 - 38 (W8))	552.0
Cash & bank	(300 + 30)	330.0
		1,851.0
Total assets		**5,816.3**
Equity:		
Equity shares		1,000.0
Share premium		500.0
Retained earnings	W2	2,784.1
		4,284.1
Non-controlling interest	W3	205.3
		4,489.4
Current liabilities:		
Trade payables	(570 + 80 - 38 (W8)	612.0
Deferred consideration	W6	190.9
Dividends proposed	W9	234.0
Current taxation	(250 + 40)	290.0
		1,326.9
Total equity & liabilities		**5,816.3**

W1 - Goodwill on acquisition of Gerhard	**€ million**	
Cost of investment:		
Cash		750.0
Deferred consideration (W6)		181.8
		931.8
Value of NCI at acquisition (ii)		200.0
Fair value of net assets at acquisition		
Equity share capital	300	
Share premium	100	
Retained earnings (see note 1 below)	460	
Fair value adjustment (iii)	36	(896.0)
Goodwill		235.8
impairment loss (iv)		(8.0)
Balance to consolidated SOFP		227.8

Note 1: Retained earnings of Gerhard at acquisition are calculated as follows:

Balance at 31 March 2017		420.0
Earnings to 1 October 2017 (6 months)	(500 - 420) * 6/12	40.0
Balance at 1 October 2017		460.0

Note 2: Goodwill impairment is charged to Gerhard's R/E so both parent and NCI suffer their share. This is appropriate as the original calculation of NCI at acquisition used the fair value method.

Alternatively, Group R/E could be charged with 80% of the impairment loss, and NCI with 20%.

W2 Retained earnings	**Angela € million**	**Gerhard € million**
Balance at reporting date	2,750.0	500.0
less balance at acquisition		(460.0)
goodwill impairment (iv)		(8.0)
Depreciation on fair value adjustment		(4.5)
Unwinding of discount on deferred consideration	(9.1)	
Share of R/E of Associate	6.0	
Unrealised profit on intra-group trading		(1.0)
Dividend receivable from Gerhard (W9)	16.0	0.0
Subtotals	2762.9	26.5
Consolidate Gerhard (80% * 27.4)	21.2	
Balance to SOFP	2,784.1	

W3 - Non-controlling Interest		**Gerhard € million**
Balance at acquisition (W1)		200.0
Share of retained earnings of Gerhard	(20% * 26.5)	5.3
Balance to SOFP		205.3

W4 - Investment in Associate		**Helmut € million**
Balance at acquisition (i)		25.0
Share of post-acquisition earnings	(61 - 37) * 25% to Angela's R/E	6.0
Balance to SOFP		31.0

W5 - Fair value adjustment		**€ million**
Balance at acquisition	to goodwill working	36.0
Depreciation since acquisition	36 / 4 years *6/12 to R/E	(4.5)
Balance at reporting date	to SOFP	31.5

W6 - Deferred consideration		**€ million**
Agreed amount of deferred consideration (payable 1 year following acquisition)		200.0
Discounted value at acquisition date	200 / 1.1 (to Goodwill)	181.8
Discount unwound by reporting date	(181.8 * 10%) * 6/12 (to R/E)	9.1
Carrying value of liability at reporting date		190.9

W7 - Intra-group trading		**€ million**
Total profit on trade	(40 - 35)	5.0
Proportion relating to goods still in group inventory at R/D		20%
Unrealised profit	Deduct from R/E of seller Deduct from group inventory	1.0

W8 - Intra-group balances outstanding	**€ million**
Balance owed from Angela to Gerhard at reporting date	38.0

Eliminate this by reducing trade receivables and trade payables by 38.

W9 - Dividends proposed		**€ million**
Angela's liability		230.0
Gerhard's liability		20.0
Intragroup dividends	20 * 80% to Angela's R/E	(16.0)
Balance to SOFP liability		234.0

(b) Explain deferred consideration:
Deferred consideration arises when an acquisition agreement provides that some of the payment due for the acquired entity will be paid to the seller at a later date. The amount is agreed in advance. This may be to assist with the cash flow management of the purchaser, or as a way for the purchaser to ensure any misrepresentations by the seller can be compensated for in the future more easily.

Accounting treatment of deferred consideration:
Deferred consideration must be recognised by the purchaser at the acquisition date at its fair value. This is normally the agreed cash amount discounted to the acquisition date at the purchaser's cost of capital. The discount is unwound over time by the purchaser, by recognising it as a finance cost in the post-acquisition period as time passes. The liability at any reporting date will be the initial fair value plus the amount of the discount that has unwound to date.

Explain contingent consideration:
Contingent consideration is when the seller and purchaser agree that a portion of the consideration be measured and paid in the future, but at the acquisition date the amount is subject to uncertainty. The amount is often dependant on the future performance of the acquired entity. For example, a further €100 million may be paid to the seller 2 years after acquisition provided profits exceed a stated figure in each of the two years.

Accounting treatment of contingent consideration:
Any contingent consideration must also be recognised at acquisition at its fair value. This will normally include a discount to reflect the time delay before payment, plus a discount to reflect the probability that the amount will be paid in part or in full. Goodwill is calculated based on this estimate. At each reporting date after acquisition, the fair value is re-estimated, with any change being taken to profit or loss (of the purchaser) in the year of re-estimation. Any change due to the unwinding of the time value of money discount is recognised as a finance cost. The revised amount is carried as a liability until further re-estimated, or paid.

Marking Scheme:

(a)

Basic consolidation (100% Angela + 100% Gerhard)	2
Calculation and treatment of goodwill (including NCI at acquisition date)	2
Subsequent treatment of deferred consideration	2
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
Dividends	2
Reserves calculation and consolidation - both	2
NCI calculation at reporting date	2
Presentation	2
Subtotal	22

(b)

Explanation of deferred consideration	2
Accounting for deferred consideration	2
Explanation of contingent consideration	2
Accounting for contingent consideration	2
Subtotal	8

Total	**30**

Solution 2
Marking scheme:

(a) Statement of Profit or Loss and Other Comprehensive Income

Transfer of figures from trial balance to appropriate headings	1
Removal of proceeds from sale of plant from revenue	1
Depreciation on buildings (calculation and inclusion in cost of sales expenses)	1
Depreciation on plant & equipment	1
Amortisation of intangibles	1
Capitalisation of buildings cost (calculation and exclusion from admin expenses)	1
Capitalisation of intangible cost (and exclusion from admin expenses)	1
Gain on disposal of Plant	1
Adjustment to finance costs re unwinding of discount on restoration provision	1
Tax (recognition in P/L)	0.5
Calculation and presentation in OCI of gain on revaluation of buildings	1
Presentation of loss on remeasurement of equity investments within OCI	1
Presentation	0.5
Subtotal	**12**

(b) Statement of Changes in Equity

Opening balances	1
Transfer of figures from SPLOCI to correct reserves	3
Presentation	1
Subtotal	**5**

(c) Statement of Financial Position

Transfer of figures from trial balance to appropriate headings	2
Land & buildings	2
Plant & equipment	2
Intangible assets	2
Loss on equity investments (calculation and recognition in NCA)	1
Transfer of figures from SOCIE to reserves	1
Tax (recognition as liability)	0.5
Restoration provision (calculation and inclusion of correct amount in liabilities)	2
Presentation	1
Subtotal	13.5 max **13**
Total	**30**

(a) Emmanuel Plc: Statement of Profit or Loss and Other Comprehensive Income for year ended 31 March 2018

		€ million
Revenue	(450 - 10 (W1))	440.0
Cost of Sales	(160 + 4.1 (W2) + 28.5	(199.6)
Gross profit	(W2) + 7(W3)	240.4
Distribution costs	(25)	(25.0)
Administration expenses	(185-27 (W2) - 11 (W3)	(147.0)
Finance costs	W5	(1.0)
Gain on disposal of plant & equipment	W1	4.0
Profit before tax		71.4
Tax	W6	(7.5)
Profit for the year		63.9
Other comprehensive income (items that will not be reclassified to profit or loss):		
Gain on revaluation of land & buildings (W2)		32.1
Loss on revaluation of equity investments (W4)		(5.5)
Other comprehensive income for the year		26.6
Total comprehensive income for the year		90.5

(b) Emmanuel Plc Statement of Changes in Equity for year ended 31 March 2018

	Share Capital € million	Share Premium € million	Revaluation Surplus € million	Equity Investments € million	Retained Earnings € million	Total Equity € million
Balance 1 April 2017	200	60.0	40	30	136	466
Profit / OCI for the year	0	0.0	32.1	(5.5)	63.9	90.5
Balance 31 March 2018	**200**	**60**	**72.1**	**24.5**	**199.9**	**556.5**

(c) Emmanuel Plc Statement of Financial Position as at 31 March 2018

		€ million
Non-current assets:		
Land & buildings,	W2	235.0
Plant & equipment	(170 - 30 (W1)) - (50-24 (W1) +28.5 (W2))	85.5
Intangible assets	(80 + 11 (W3) - 7 (W3))	84.0
Equity investments	(64-5.5 (W4))	58.5
		463.0
Current assets:		
Inventory	(42	42.0
Trade receivables	(50	50.0
Cash & bank	(60	60.0
		152.0
Total assets:		**615.0**
Equity:		
Equity share capital	(b)	200.0
Share premium	(b)	60.0
Revaluation surplus	(b)	72.5
Equity investment reserve	(b)	24.5
Retained earnings	(b)	199.5
		556.5
Current liabilities:		
Trade payables	(30	30.0
Provision for restoration costs	(20 + 1 (W5)	21.0
Corporation tax due	W6	7.5
		58.5
Total equity & liabilities		**615.0**

Workings:

W1 – Revenue

This item should not be included in revenue, as revenue should consist of goods sold in the ordinary course of business. The sale of a non-current asset does not fall into this category.

The asset and its accumulated depreciation should be derecognised, and a profit or loss on disposal calculated.

	€ million	€ million
Cost of item sold	30	
Accumulated depreciation to date of sale (none in year of sale)	(24)	
Carrying value at date of sale	6	
Proceeds	10	
Profit on disposal	4	
Adjustment:		
Dr Revenue	10	
Dr Accumulated depreciation plant & equipment	24	
Cr Plant & equipment at cost		30
Cr profit or loss (gain on disposal)		4

W2 – Non-current assets

New building:

The additional expenditure directly incurred on construction of new buildings should be capitalised to land & buildings. This amounts to €27 million as management time and apportioned overhead are not considered direct costs under IAS 16. Hence:

	€ million	€ million
Dr Land & buildings	27	
Cr Administration expenses		27

Depreciation of land & buildings:

As the revaluation took place on the last day of the year, depreciation should be calculated for the year on buildings only based on the existing values. The new building should be included because a full year's depreciation is provided in the year of acquisition.

	€ million
Buildings at valuation (per T/B less land 200-20)	180
Cost of new building (as calculated above)	27
Base for depreciation charge	207
Depreciation (2% of cost or valuation = 2% * 207m):	4.14

Hence:

	€ million	€ million
Dr Cost of sales	4.1	
Cr Accumulated depreciation: land & buildings		4.1

Revaluation of land & buildings:

At 31 March 2018, the land & buildings were revalued as follows:	**Land**	**Buildings**
Revalued amount (per note (ii)):	25	210
Carrying amount after depreciation and new building (see below)	(20)	(182.9)
Revaluation gain (to OCI)	5	27.1

Carrying amount of buildings prior to revaluation	
Previous valuation (200 – 20 for land)	180
Cost of new building	27
Accumulated depreciation to 31 March 2017	(20)
Depreciation for year ended 31 March 2018 (calculated above)	(4.1)
Carrying value prior to revaluation	182.9

We should eliminate all accumulated depreciation, and show the land and buildings at their new carrying value of €235 million, up from their existing valuation + cost (of 200 + 27).

Hence:

	€ million	€ million
Dr Accumulated depreciation (20 + 4.1)	24.1	
Dr Land & buildings (235 – 227)	8	
Cr Other comprehensive income		32.1

Depreciation of plant & equipment:

	€ million
Plant & equipment at cost (per T/B less plant disposal) (170 – 30)	140
Accumulated depreciation to 31 March 2017 less disposal (50 – 24)	(26)
Base for depreciation charge	114
Depreciation (25% of NBV = 25% * 114m):	(28.5)

Hence:

	€ million	€ million
Dr Cost of sales	28.5	
Cr Accumulated depreciation: plant & equipment		28.5

W3 – Intangible assets
Additional intangible
The €11 million charged to administration expenses should be capitalised as an intangible as it meets the criterial for capitalisation. Hence:

	€ million	**€ million**
Dr Intangible assets	11	
Cr Administration expenses		11

Amortisation
The entire amount should now be amortised over the useful economic life of 13 years. Amount of amortisation (80 + 11) / 13 years = €7 million.
Hence:

	€ million	**€ million**
Dr Cost of Sales	7	
Cr Accumulated amortisation – intangible assets		7

W4 – 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 Angela, hence the loss in value of €5.5 million (58.5 – 64) should be taken to OCI as well as being reflected in the carrying value of the equity investments.
Hence:

	€ million	**€ million**
Dr Other comprehensive income	5.5	
Cr Financial assets		5.5

W5 – Restoration provision
The current liability needs to be updated at each reporting date to reflect the unwinding of the discount originally recognised in measuring the fair value of the provision required.
Amount unwinding in year ended 31 March 2018 (20m * 5%) €1 million

As the existing provision is recorded at €20 million, an additional charge of €1 million must be made, bringing the provision up to €21 million. This should be charged to profit or loss (through finance costs), and added to the existing provision.
Hence:

	€ million	**€ million**
Dr Profit or loss – finance costs	1	
Cr Provision for restoration costs		1

W6 – Tax liability
The estimate should be incorporated into the financial statements.
Hence:

	€ million	**€ million**
Dr Profit or loss (taxation)	7.5	
Cr Current liability (tax payable)		7.5

SOLUTION 3
Each correct answer gains 2.5 marks. No partial marks are awarded. Workings are not marked.

1 **Answer (a)**
The others are all explicitly stated to be enhancing characteristics.

2. **Answer (b)**
The acid test ratio is (current assets – inventory) as a ratio of current liabilities. Hence the difference between them of 0.8:1 is entirely due to the exclusion of inventory. Hence inventory must be 0.8 times current liabilities.

3. **Answer (c)**
If sales revenue decreased in 2017, the only way the gross margin could increase is if cost of sales fell by a greater amount than sales revenue.

4. **Answer (b)**
As the ROCE is a blend of the ROE and the cost of debt, ROCE will be a weighted average of both. If ROE is higher, this means that the cost of debt is below the average.

5. **Answer (b)**
The cost of acquiring non-current assets is always included under “investing activities”.

6. **Answer (a)**
The provision should be adjusted to the required amount. This is a reduction from €3.2 million to €1.0 million, or €2.2 million debited to the provision. The credit is to profit or loss.

7. **Answer (d)**
Biological assets are those assets that are growing naturally. Once they are harvested, they cease to be biological assets and become normal inventory, accounted for under IAS 2.

8. **Answer (c)**
The TERP is the expected price at which a share will trade after a rights issue, taking into account its actual price before the rights issue together with any dilution arising from the rights issue itself.

SOLUTION 4

Marking Scheme:

(a)	10 correct points, including the 5 steps, at 1 mark each	
	Subtotal	**10**
(b)		
(i)	Recognition that total revenue recognised is based on goods delivered by the reporting date	1
	Recognition that the deferred payment requires a present value to be calculated	1
	Accurate calculations and journal entry	3
(ii)	Recognition that revenue recognised is based on rooms actually occupied	1
	Recognition that a deferred revenue account is used for remainder	1
	Accurate calculations and journal entry	3
	Subtotal	**10**
	Total	**20**

(a) Revenue is recognised when an entity satisfies a performance obligation by transferring a promised good or service to a customer. However, a good or service is only considered transferred when the customer obtains control of that good or service.

This is an asset/liability-driven approach, consistent with the Conceptual Framework.

This approach has 5 steps:

(1) Identify the contract with the customer;
Agreement between the parties;
Each party's rights can be identified;
Payment terms can be identified;
The contract has commercial substance;
It is probable the consideration will be collected.

(2) Identify the performance obligation(s);
May be single or multiple performance obligations;
If multiple, each portion capable of being sold separately is identified.

(3) Determine transaction price;
Agreed price;
Probability weighted expected price if uncertain;
Should be net of expected rebates and discounts;
Should include the effect of the customer's credit rating and time value of money if relevant.

(4) Allocate transaction price to performance obligations;
Only relevant if multiple deliverables exist in the contract;
The transaction price is allocated to the deliverables in the ratio of the stand alone selling prices of each individual deliverable.

(5) Recognise revenue when performance obligation satisfied.
This is normally when control is transferred to the customer;
Control may be transferred at one point in time, or over a period of time;

If a performance obligation is delivered over time, revenue is only recognised if ONE OF the following criteria is met:

- The customer consumes the service as it is supplied;
- The customer controls the asset as it is created in stages;
- The entity's performance does not create an asset with alternative uses to the entity, and the entity has an enforceable right to payment for work completed.
- The entity must be reasonably able to assess the outcome of the performance

Revenue shall be measured at the fair value of the consideration received or receivable. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (ie an exit price) (IFRS 13).

Further issues

- Selling costs directly incurred in earning a sales contract are capitalised and recognised over the period revenue from that contract is recognised. Example – sales commission for a 12 month phone service contract.
- Costs incurred in meeting the terms of a contract are capitalised and recognised against revenue provided they relate directly to an identifiable contract, help satisfy the obligations under the contract, and are expected to be recovered.
- Goods expected to be returned are not to be recognised as revenue. An estimate should be made of the amount expected to be returned.
- A warranty is often a separate deliverable in a sales contract. As such it is treated as a component of the deal. The revenue is separated, and the portion relating to the warranty is recognised over the warranty period. If the warranty is inseparable from the goods supplied (i.e. is not separately available, then a provision is made under IAS 37.
- If goods are sold as agent rather than as principal, only the commission receivable is recognised as revenue.
- If a sales contract grants the purchaser an option to purchase further goods / services at a discount, this is treated as a separate performance obligation. Example – air miles, discount coupons. The fair value is estimated and revenue recognised on delivery or expiry.

(10 marks)

(b)

(i) The contract to supply is not sufficient to recognise revenue. It is necessary that control of the goods have actually transferred to the customer. This is the case for 300 units.

The deferred payment does not prevent revenue from being recognised, but the consideration needs to be measured at the fair value, on the transaction date, of the amount receivable. The fair value needs to reflect a discount allowing for the time value of money, as a result of the extended credit period. The discount rate will be 10%, Derek's cost of capital.

Hence revenue will be recognised as follows: 300 units * €1,000 * 1/1.10 = €272,727

The discount will be recognised as finance income as time passes, on a time-apportioned basis. As the sale took place on 31 March 2018, no time has yet passed to trigger the recognition of finance income.

Journal:	**€**	**€**
Dr trade receivables	272,727	
Cr Revenue		272,727
(recognition of revenue and trade receivables at fair value of consideration receivable)		

(5 marks)

(ii) Again, the same principles apply. Revenue is recognised when control of the goods or services are transferred to the customer.

Here, cash was received in advance. Nevertheless, revenue is only recognised when the service is delivered to the customer. Any excess cash retained is recognised as deferred income, a liability.

If the cash is non-refundable, this does not change the timing of recognition of revenue. However, if the customer's right to the service expires, and the customer has no right to a refund, the revenue should then be recognised.

Total cash received in year ended 31 March 2018: 2000 * €100 = €200,000
Total room nights provided 400
Revenue recognised = 400 * €100 = €40,000
Deferred revenue = 200,000 – 40,000 = 160,000

Journal:	**€ 000**	**€ 000**
Dr Cash	200	
Cr Revenue		40
Cr Deferred revenue		160
(recognition of revenue, deferred revenue and cash received)		

(5 marks)

[Total: 20 MARKS]

SOLUTION 5

Marking Scheme:

(a)	8 valid points at 1 mark each	
	Subtotal	**8**
(b)		
(i)	Calculation of interest incurred	2
	Calculation of amount to capitalise	2
	Journals	2
(ii)	Calculation of interest incurred	1
	Calculation of interest earned on investment	1
	Calculation of amount to capitalise	2
	Journals	2
	Subtotal	**12**
	Total	**20**

(a) Most borrowing costs are treated as an expense as incurred. However a special case exists in the case of interest paid on money borrowed to bring a substantial asset into use.

The required treatment is to capitalise such borrowing costs as part of the cost of the asset subject to the following conditions:

- The asset takes a substantial period of time to get ready for its intended use (or sale);
- The borrowing costs can be reliably measured;
- Only costs incurred up to the time the asset is substantially ready for use may be considered for capitalisation.
- To the extent that funds are borrowed specifically for the purpose of obtaining a qualifying asset, the amount of borrowing costs eligible for capitalisation on that asset shall be determined as the actual borrowing costs incurred on that borrowing during the period less any investment income on the temporary investment of those borrowings.
- If general borrowed funds are used to purchase an asset, then an average borrowing rate may be applied to expenditures on the asset, provided the total borrowing costs capitalised do not exceed the total borrowing costs incurred.
- The capitalised cost of any asset cannot exceed its recoverable amount (see IAS 36).

Commencement, suspension and cessation of capitalisation
The capitalisation of borrowing costs as part of the cost of a qualifying asset shall commence when:

- expenditures for the asset are being incurred;
- borrowing costs are being incurred; and
- activities that are necessary to prepare the asset for its intended use or sale are in progress.

Capitalisation of borrowing costs shall be suspended during extended periods in which active development is interrupted.

Capitalisation of borrowing costs shall cease when substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete.

(8 marks)

(b)
(i) Henry Plc will capitalise the interest incurred when:

- expenditures for the asset are being incurred;
- borrowing costs are being incurred; and
- activities that are necessary to prepare the asset for its intended use or sale are in progress.

Interest is incurred for 9 months from 1 July 2017 until 31 March 2018.
Amount incurred was €5 million * 8% * 9/12 = €300,000.
Expenditures are being incurred from 1 June 2017, so the commencement precedes the raising of the loan.

Activities necessary to prepare the asset for use are ongoing throughout this period except for one month when the workers were on strike.

Hence all three conditions were met for 8 months of the year. Hence we should capitalise €300,000 * 8/9, and expense €300,000 * 1/9.

Journal:

31 March 2018	Dr Non-current assets	€266,667
	Dr Profit or loss	€33,333
	Cr Cash	€300,000

(6 marks)

(ii) Georgina Plc will capitalise the interest incurred when:

- expenditures for the asset are being incurred;
- borrowing costs are being incurred; and
- activities that are necessary to prepare the asset for its intended use or sale are in progress.

Interest is incurred for 12 months from 1 April 2017 until 31 March 2018.
Amount incurred was €2 million * 6% = €120,000.
Expenditures are being incurred from 1 April 2017 to 30 November 2017 (8 months).
Activities necessary to prepare the asset for use are ongoing throughout this period.

Hence all three conditions were met for 8 months of the year. The interest incurred during this period was €120,000 * 8/12, or €80,000. The balance is expensed to profit or loss (€40,000).

However, interest income from temporary investment should be netted against the amount capitalised, as it was earned during this period. Interest received amounted to:

- €2 million @ 2% * 3/12 = €10,000; plus
- €0.8 million @ 3% * 3/12 = €6,000

Total interest received €16,000.

Journal:

31 March 2018	Dr Non-current assets (80-16)	€64,000	
	Dr Profit or loss	€40,000	
	Cr Cash		€104,000

(6 marks)

[Total: 20 MARKS]