CORPORATE REPORTING

PROFESSIONAL 1 EXAMINATION - AUGUST 2015

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: Students 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. Adams plc (Adams) is a public limited company based in Ireland. It has shareholdings in two other companies, Truman plc (Truman) and Carter plc (Carter). Statements of Financial Position are shown below for all three companies as at 31 July 2015.

Statements of Financial Position as at 31 July 2015

	Adams plc € million	**Truman plc € million**	**Carter plc € million**
Non-current assets:			
Property, plant & equipment	500	145	100
Investments	300	48	5
	800	193	105
Current assets:			
Inventories	180	51	23
Trade receivables	64	24	13
Cash & bank	24	13	8
	268	88	44
Total assets	1,068	281	149
Equity:			
Equity share capital of €0.25 each	250	100	40
Share premium	200	80	20
Retained earnings	358	65	61
	808	245	121
Non-current liabilities:			
6% loan notes	100	---	---
Current liabilities:			
Trade payables	143	36	18
Dividends proposed	17	---	10
Total liabilities	260	36	28
Total equity & liabilities	1,068	281	149

The following additional information may be relevant:

(i) Adams bought 300 million ordinary shares in Truman on 1 August 2013, when the retained earnings of Truman were €44 million. The consideration was agreed at €220 million for these shares. €120 million of this was settled in cash on the date of purchase, the balance being paid by means of a 6% loan note. This investment has been correctly recorded at cost in the books of Adams, included under the heading "Investments". The loan note interest was paid during the year ended 31 July 2014, but no entry has been made to reflect the interest payable in the current accounting period.

(ii) Adams bought a 40% holding in the ordinary shares of Carter on 1 August 2014, when the retained earnings balance in Carter's books stood at €52 million. The consideration consisted of an immediate cash payment of €50 million. The directors of Adams negotiated the right to appoint 4 directors to Carter's 12-person board as a result of its investment.

(iii) The group accounting policy is to value any Non-Controlling Interests (NCI) at their proportionate share of identifiable net assets at the acquisition date.

(iv) On 1 August 2013, certain property held by Truman had a fair value €20 million in excess of its carrying value. The buildings component of this property, comprising 75% of the total value, had a useful economic life remaining of 10 years at the date of acquisition.

(v) During the financial year ended 31 July 2015, Truman had sold goods to Adams amounting to €60 million. The purchase price included a mark-up of 20% on cost. Truman's normal mark-up on goods sold is 60%. Of these goods, one-quarter remained in the closing inventory of Adams at the reporting date.

(vi) Recorded in the books of Adams was an intra-group trade payable of €20 million owed to Truman at year-end. However, the books of Truman showed a balance of €22 million owed by Adams. It transpired that Truman's computer system had automatically charged to Adams' account interest of €2 million due to late payments. It was subsequently agreed that Truman would waive this interest.

(vii) Adams has not accounted for any dividend receivable from its group companies. Both Adams and Carter have proposed dividends as shown in current liabilities. Carter's proposed dividend relates entirely to the post-acquisition period. No other dividends were paid or proposed in the year.

(viii) Goodwill was reviewed for impairment at the reporting date, and a €3 million impairment loss was considered necessary to the goodwill of Truman. A €1 million impairment loss should be provided for on the investment in Carter.

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

REQUIREMENT:

(a) Prepare the Consolidated Statement of Financial Position for the Adams group as at 31 July 2015 in accordance with International Financial Reporting Standards. (23 marks)

Format & Presentation (1 mark)

(b) If you were a non-controlling shareholder in Truman, you might be concerned regarding certain implications of the transactions described in notes (v) and (vi) above. Outline clearly the nature of and reasons for any concerns a prudent shareholder might have.

(6 marks)

[Total: 30 MARKS]

2. The following trial balance was extracted from the books of Zebedee plc (Zebedee), a construction company, on 31 July 2015.

	Note	Dr € million	Cr € million
Revenue	(ii)		1,041.6
Cost of sales		618.8	
Distribution costs		128.8	
Administration expenses		207.2	
Interest paid	(i)	11.2	
Land	(i)	42.0	
Buildings	(i)	131.6	
Plant and equipment at cost	(i)	168.0	
Accumulated depreciation 1 August 2014 - plant and equipment	(i)		56.0
Intangible assets at valuation	(iii)	84.0	
Financial assets at fair value 1 August 2014	(viii)	196.0	
Inventory at 31 July 2015		50.4	
Trade receivables		193.2	
Cash and bank		78.4	
Trade payables			78.4
Equity shares of €5 each	(vi)		196.0
4% cumulative redeemable preference shares 2019	(vii)		56.0
Revaluation surplus	(i) (iii)		112.0
Provision for warranty	(iv)		42.0
10% Debenture (issued on 1 August 2014)			112.0
Corporation Tax	(v)	14.0	
Retained earnings reserve 1 August 2014			229.6
		1,923.6	1,923.6

The following notes may be relevant, and where so, you are to consider all figures material:

(i) Land and buildings consists of the fair valuation of buildings held at 1 August 2014 (valued at that date) plus €17 million being the capitalised cost of new buildings constructed during the year. This amount includes materials and labour incurred on the construction. Indirect overheads apportioned based on the labour cost of the construction work amounted to €3.5 million. These have not been capitalised and are included in "administration expenses". A portion of the debentures has been used directly to fund the construction work. Interest on this portion for the year amounted to €1.2 million. This is included within "interest paid". The old buildings have a useful economic life of 30 years as on 1 August 2014. The new building has a useful life of 50 years from its date of completion, 31 July 2015. No depreciation has yet been charged for the year. Buildings are depreciated on a straight line basis over their useful economic life.

Plant & equipment is depreciated at 25% reducing balance per annum.

All depreciation is charged to cost of sales.

(ii) Revenue includes €22 million in respect of goods sold to a customer on a consignment (sale-or-return) basis. These were treated as normal sales in the books and included a 30% profit margin on selling price. However, the customer has given no indication to date whether she plans to keep or return the goods.

(iii) During the year, the directors decided their brand was very valuable. They commissioned a professional firm to measure its value. The advice of the professional firm was that the brand had a value of €30 million. Accordingly, it was decided to recognise this in the books, and the directors credited "revaluation surplus" with the same amount. No amortisation should be charged on intangible assets.

(iv) Zebedee offers a 12 month warranty on goods and services supplied. It is expected that, on average, 4% of such goods or services will prove faulty. The average cost of rectifying flaws is 120% of sales prices.

(v) The corporation tax balance is the balancing amount on the taxation liability account after recording payment of the liability for year ended 31 July 2014. The estimate for the current year's liability is €3 million.

(vi) The directors of Zebedee have decided prior to the reporting date to propose an equity dividend of €0.40 per equity share. All shares in issue rank fully for dividend.

(vii) The preference shares were issued on 1 February 2015. The preference dividend for the year has not yet been provided for. The directors wish to provide for this payment.

(viii) Financial assets consist of equity investments. An election has been made to recognise all remeasurement gains or losses in "other comprehensive income" under IFRS 9 *Financial Instruments*. The fair value of these investments at 31 July 2015 was €76 million. No acquisitions or disposals occurred during the year. Zebedee uses revaluation surplus to accumulate gains and losses on these investments.

REQUIREMENT:

Prepare, in a form suitable for publication to the shareholders of Zebedee, the:

(a) Statement of Profit or Loss and Other Comprehensive Income of Zebedee for the year to 31 July 2015;
(12 marks)
Format & Presentation (1 mark)

(b) Statement of Changes in Equity for year ended 31 July 2015; (5 marks)

(c) Statement of Financial Position as at 31 July 2015. (11 marks)
Format & Presentation (1 mark)

[Total: 30 MARKS]

Notes to the financial statements are not required but all workings should be shown.

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.

The following information applies to the Grennan Group plc for year ended 31 July 2015, and should be used to help answer Questions 1 to 4 below:

Revenue	€250 million
Gross margin	20%
Net margin (based on profit before interest and tax)	8%
Inventory turnover per annum	14 times
Return on capital employed (based on profit before interest and tax)	12%

1. Based on the above information, what is the most reasonable estimate for the net amount of operating expenses incurred for the year?

   (a) €20 million
   (b) €30 million
   (c) €50 million
   (d) Impossible to estimate from the available data.

2. If the financial statements on which the above figures are based were subsequently altered to increase the tax charge for the year, what would be the most likely effect on the "return on capital employed" ratio?

   (a) It would decrease
   (b) It would not change
   (c) It would increase
   (d) Impossible to estimate from the available data.

3. What is the average number of days for which inventory is held (to the nearest whole day)?

   (a) 14 days
   (b) 18 days
   (c) 26 days
   (d) Impossible to estimate from the available data.

4. What is the asset turnover ratio for the company?

   (a) 67%
   (b) 96%
   (c) 150%
   (d) Impossible to estimate from the available data.

5. The Financial Reporting Council (FRC) has recently issued FRS 100, FRS 101 and FRS 102.

   FRS 100 to 102 apply to the following entities:
   (i) Non-publicly quoted for-profit entities
   (ii) Publicly quoted entities
   (iii) Not-for-profit entities
   (iv) Any entity that chooses to use them.

   Regarding the above statements, which of the following options is correct?

   (a) (iv)
   (b) (i) and (ii)
   (c) (ii) and (iii)
   (d) (i) and (iii).

6. Liam plc has 100 units of raw material in inventory at 31 July 2015. These cost a total of €30,000. Since purchasing the material, the purchase price has dropped to €19,000. However the material will be incorporated into a final product which is expected to sell for €75,000 after further conversion costs of €25,000 are incurred.

   At what amount should the inventory be carried in the financial statements for year ended 31 July 2015?

   (a) €19,000
   (b) €20,000
   (c) €30,000
   (d) €50,000.

7. Allingham plc reported profit before taxation of €45 million for the year ended 31 July 2015. The tax charge on profit was €8 million, and other comprehensive income totalled €5 million. If there were 30 million equity shares in issue for the year how much should be reported as basic earnings per share?

   (a) €1.23
   (b) €1.40
   (c) €1.50
   (d) €1.67.

8. IFRS 8 requires an entity to disclose segmental information for certain sections of the business designated "reportable segments". Which of the following statements is NOT TRUE when it comes to defining reportable segments?

   (a) There are three quantitative tests: revenue, assets and profit. In order to be a reportable segment, all three of these must be met.
   (b) Reportable segments must account in total for at least 75% of revenue. If not, further segments must be identified until this is the case.
   (c) Any segment deemed important by the entity may be deemed a reportable segment even if it does not meet other criteria;
   (d) For a segment to be reportable, separately reported information must be available internally to the chief operating decision maker.

[Total: 20 MARKS]

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

4. The IASB's *Conceptual Framework for Financial Reporting* attempts to set out the concepts that underlie the preparation and presentation of financial statements for external users. The most recent version was issued in September 2010.

REQUIREMENT:

(a) Discuss the purpose and status of the Conceptual Framework. In particular, you should cover the aims of the framework and its status in the event of a conflict between it and a particular standard. (10 marks)

(b) Outline the advantages and disadvantages of having a statement such as the Conceptual Framework.

(10 marks)

[Total: 20 MARKS]

<u>OR</u>

5.

(a) IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* lays down criteria for the selection of accounting policies and prescribes circumstances in which an entity may change an accounting policy. The standard also deals with accounting treatment of changes in accounting policies, changes in accounting estimates and correction of prior period errors.

REQUIREMENT:

(i) Define an accounting policy according to IAS 8. Explain briefly the difference between an accounting policy and an accounting estimate. (4 marks)

(ii) Outline the accounting treatment required to record (1) a change in accounting policy, (2) a change in accounting estimate and (3) the correction of an error. (6 marks)

(b) The following are summaries of the draft financial statements of Sigma plc for financial year ended 31 July 2015 together with the comparative figures for 2014. During August 2015, prior to the signing off of the financial statements, it was discovered that a fraud had been taking place in the company for the previous three years. The chief financial officer had been misappropriating monies paid to the company by its customers, the amounts instead appearing as receivables. The effect of the fraud was that amounts shown in the financial statements as receivables need to be written off as they were in fact paid. There is no prospect of recovering the money as the employee lost it gambling and is now bankrupt. The amounts were as follows for each period ending on the following dates:

31 July 2013: €14,000
31 July 2014: €16,000
31 July 2015: €20,000.

Statements of Profit or Loss and Other Comprehensive Income for year ended 31 July:

	2015	**2014**
	€'000	**€'000**
Revenue	300	275
Cost of Sales	(225)	(212)
Gross Profit	75	63
Expenses	(30)	(26)
Profit for year	45	37

Statements of Changes in Equity (Retained Earnings only) for year ended 31 July:

	2015	**2014**
	€'000	**€'000**
Balance 1 August	258	236
Profit for the year	45	37
Dividends declared	(16)	(15)
Balance 31 July	287	258

Statements of Financial Position as at 31 July:

	2015	**2014**
	€'000	**€'000**
Non-current Assets	294	306
Net Current Assets	143	102
	437	408
Equity Share Capital	150	150
Retained Earnings	287	258
	437	408

REQUIREMENT:

Restate the above financial statements, including comparatives, incorporating the adjustments you deem necessary as a result of the fraud. Ignore the effect of taxation. Disclosure notes are not required.

(10 marks)

[Total: 20 MARKS]

END OF PAPER

SUGGESTED SOLUTIONS

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CORPORATE REPORTING

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SOLUTION 1

Marking Scheme:

(a)	Basic consolidation (100% Adams + 100% Truman)	3
	Goodwill and impairment thereof (including NCI at acquisition date)	3
	Recording of interest on loan note	2
	Investment in associate calculation and impairment	2
	Fair value adjustments and post acq movements	2
	Intra group sales of inventory	2
	Intra group balances outstanding & elimination of interest charged	3
	Dividend receivable from associate	1
	Reserves calculation and consolidation	3
	NCI calculation at reporting date	2
	Presentation	1
	Subtotal	**24**

(b)	Problem of parent enforcing its control at cost to NCI – minority infringement?	2
	Taking goods at lower than standard mark-up costs NCI and benefits parent	2
	Waiver of interest again suggests that parent is forcing advantage to itself.	2
		6

[Total: 30 Marks]

Suggested Solution

(a) Group structure:

Adams owns 300m shares out of 400m in Truman. This gives 75% ownership in Truman for 2 full years therefore Truman is a subsidiary.

Adams has 40% ownership in Carter for the full year and can appoint directors, hence significant influence is exerted. Therefore Carter is an associate.

Consolidated Statement of Financial Position of Adams Group plc as at 31 July 2015

	€ million
Non current assets: [Plan = 100% Adams + 100% Truman]	
Property, plant and equipment (500 +145 +17 (W5))	662.0
Goodwill (W1)	34.0
Investment in Associate (W4)	52.6
Other investments (300 -220 -50 +48)	78.0
	826.6
Current assets:	
Inventories (180 +51 -2.5 (W6))	228.5
Trade receivables (64 +24 -2 (W7) -20 (W7))	66.0
Dividend receivable from Associate (W8)	4.0
Cash & bank (24 +13)	37.0
	335.5
Total assets	**1,162.1**
Equity:	
Equity shares	250.0
Share premium	200.0
Retained earnings (W2)	365.7
	815.7
Non-controlling interest (W3)	64.4
	880.1
Non-current liabilities:	
6% loan note	100.0
Current liabilities:	
Trade payables (143 +36 -20 (W7))	159.0
Interest due on 6% loan notes (W1)	6.0
Dividends proposed (17)	17.0
	282.0
Total equity & liabilities	**1,162.1**

W1 Calculation of goodwill on acquisition of Truman

			€ million
Consideration			
Loan notes			100
Cash			120
			220
Value of NCI (25% * 244)			61
FV of net assets acquired			
Equity share capital		100	
Share premium		80	
Pre-acquisition reserves		44	
FVA – Property (W5-note iv)		20	(244)
Goodwill			37
Impairment loss (note (viii))			(3)
Balance			34

Note:

(1) Goodwill impairment is charged entirely to group retained earnings as is appropriate for the method used (proportion of identifiable net assets).

(2) Interest for the year needs to be provided for (€100m * 6%):

Dr Retained earnings reserve	€6m	
Cr Current liabilities		€6m

W2 Group retained earnings at 31 July 2015

	Adams € million	Truman € million
Balance per SOFP (total at y/e)	358	65
Less balance at acquisition (note (i))		(44)
Interest due on 6% loan notes (W1)	(6)	
Movement on FVA (buildings) (W5)		(3)
URP in inventory re intra-group sale of goods to Adams (W6)		(2.5)
Elimination of interest charged to Adams (W7)		(2.0)
Dividend receivable from Associate (W8)	4.0	
Goodwill impairment re Subsidiary (W1)	(3.0)	
Adjusted reserves for consolidation	353.0	13.5
Consolidate Truman (75% * 13.5)	10.1	
Share of retained earnings of associate (40% * (61-52))	3.6	
Impairment loss on investment in associate	(1.0)	
Group total	365.7	

W3 Non-controlling interest at 31 July 2015

	Truman € million
Balance at acquisition (proportional value from W1)	61
Share of post-acquisition reserves from W2 (25% * 13.5)	3.4
Total	64.4

W4 Investment in Associate

	Carter € million
Balance at acquisition (proportional value from W1)	50
Share of post-acquisition reserves from 40%*(61 -52)	3.6
Impairment loss	(1)
Total	52.6

W5 Fair value adjustments (note (iv)):

	At acquisition	Movement	At rep. date
Property Carter	€20m	(€3m)**	€17m

**Movement = depreciation of the adjustment to the <u>buildings component only</u> for 2 full years since acquisition: €20m * 75% / 10 yrs * 2 yrs = €3m. This is charged to the earnings of the company which holds (and therefore depreciates) the asset, namely Carter. Hence:

Dr PPE	€17.0m	
Dr Retained earnings – Carter	€3.0m	
Cr Goodwill (FV net assets)		€20.0m

W6 Intra-group trading of goods

Unrealised profit (URP) on goods held in closing inventory:

(€60m * 20/120) * 1/4 (sold by Truman therefore NCI IS affected)		€2.5m
Adjustment to reduce reserves (Truman) and Inventory:		
Dr Retained Earnings (Truman)	€2.5m	
Cr Inventory		€2.5m

W7 Intra-group balance outstanding & interest charged – Adams & Truman

Eliminate interest €2m:

Dr Retained earnings (Truman)	€2.0m	
Cr Trade receivables (Truman)		€2.0m

Following the above adjustment, the intra group receivables and payables now balance at €20.0m. Hence we must cancel those balances.

Dr Trade payables	€20.0m	
Cr Trade receivables		€20.0m

W8 Dividends

Carter's proposed dividend	€10m
Amount payable to parent company (40%)	€4m

Adjustment to show dividend receivable by Adams and increase retained earnings (Adams).

Dr Dividends receivable	€4.0m	
Cr Retained earnings (Adams)		€4.0m

(b) Any time a shareholder is in a minority situation on the share register, he/she should be alert for any sign that the majority holder(s) is (are) abusing their power, or colluding with each other to gain advantage at the expense of the minority shareholders.

Here, in note (v), there is a strong indication that Adams, the controlling shareholder, is buying goods from Truman at an unusually low price. The mark-up on sales to Adams is just one third of normal. The amount of lost profit on €60 million worth of trading in the year to July 2015 was €20 million (60m * 100/120 * (60%-20%)). Now this may be legitimate in that any customer buying those volumes may receive a discount of that magnitude. However it would cause me serious concern as a minority shareholder. I would fear that Adams may be abusing its controlling stake to reduce the price it pays my company for goods.

In note (vi) it is suggested that Adams may be slow in paying its debts to Truman, triggering an automatic accrual of interest. The fact that this was waived again suggests Adams exerted its influence as a controlling shareholder. I would be interested in learning the circumstances of such waiver.

In both cases, I would be interested in finding out whether there is anyone looking out for the interests of the minority shareholders. Non-executive directors would be a minimum recommendation, and I would prefer to have direct representation on the board of Truman.

SOLUTION 2

Marking Scheme:

(a)	Statement of profit or loss and other comprehensive income	
	Transfer of figures from trial balance to appropriate headings	2
	Capitalisation of overheads into buildings cost and exclusion from admin exp.	1
	Capitalisation of interest into buildings cost and exclusion from finance costs	1
	Depreciation on buildings (calculation and inclusion in expenses)	1
	Depreciation on plant & equipment	1
	Exclusion of sale or return goods from revenue	1
	Inclusion of sale or return goods in closing inventory at cost price	1
	Adjustment to admin expenses re warranty provision	1
	Tax (calculation and recognition in P/L)	1
	Preference dividend (calculation and inclusion in finance costs)	1
	Presentation of gain on remeasurement of equity investments within OCI	1
	Presentation	1
	Subtotal	**13**
(b)	Statement of Changes in Equity	
	Transfer of figures from trial balance to appropriate headings	1
	Eliminate recognition of brand from revaluation surplus	1
	Transfer of SPLOCI figures to correct equity account	2
	Calculation of dividend proposed and deduction from retained earnings	1
	Subtotal	**5**
(c)	Statement of Financial Position	
	Transfer of figures from trial balance to appropriate headings	2
	Correct capitalised amount for new building	1
	Depreciation of plant & equipment	1
	Depreciation of buildings	1
	Elimination of sale or return goods from trade receivables	1
	Inclusion of sale or return goods in inventory at cost	1
	Gain on equity investments (calculation and recognition in NCA)	1
	Transfer of figures from SOCIE to reserves	1
	Equity dividends proposed (calculation and inclusion in liabilities)	1
	Tax (recognition as liability net of existing balance)	1
	Preference dividends (calculation and recognition as liability)	1
	Warranty provision (calculation and inclusion of correct amount in liabilities)	1
	Presentation	1
	Subtotal	**14 - Max 12**

Suggested Solution

(a) Zebedee plc:

Statement of Profit or Loss and Other Comprehensive Income for year ended 31 July 2015

		€ million
Revenue	(1,041.6 - 22 (note (ii))	1,019.6
Cost of Sales	(618.8 – 15.4 (ii) + 3.8 (i) + 28 (i))	(635.2)
Gross profit		384.4
Distribution costs	(128.8)	(128.8)
Administration expenses	(207.2 – 3.5 (i) + 6.9 (iv)	(210.6)
Finance costs	(11.2 – 1.2 (i) +1.1 (vii)	(11.1)
Profit before tax		33.9
Tax (vi)		(17.0)
Profit for the year		16.9
Other comprehensive income: Items that will not be reclassified to profit or loss		
Loss on revaluation of investments (viii)		(120.0)
Total comprehensive income for the year		(103.1)

(b) Zebedee plc Statement of Changes in Equity for year ended 31 July 2015

	Share Capital €million	Revaluation Surplus €million	Retained Earnings €million	Total Equity €million
Balance 1 August 2014	196.0	112.0	229.6	537.6
Derecognition of brand name (iii)		(30.0)		(30.0)
Total comprehensive income		(120.0)	16.9	(103.1)
Dividends declared (vi)			(15.7)	(15.7)
Balance 31 July 2015	196.0	(38.0)	230.8	388.8

(c) Zebedee plc Statement of Financial Position as at 31 July 2015

		€ million
Non-current assets:		
Land & buildings,	(42 + 131.6 +3.5 (i) + 1.2(i) -3.8(i)	174.5
Plant & equipment	(168 – 56 – 28 (i)	84.0
Intangible asset	(84 – 30 (iii)	54.0
Financial assets	(196 - 120 (viii))	76.0
		388.5
Current assets:		
Inventory	(50.4 +15.4 (ii)	65.8
Trade receivables	(193.2 -22 (ii)	171.2
Cash & bank	(78.4)	78.4
		315.4
Total assets:		**703.9**
Equity:		
Equity share capital		196.0
Revaluation surplus	(b)	(38.0)
Retained earnings	(b)	230.8
		388.8
Non-current liabilities:		
4% cumulative redeemable preference shares		56.0
10% debenture	(112)	112.0
		168.0
Current liabilities:		
Trade payables	(78.4)	78.4
Provision for warranty claim	(42 + 6.9 (iv)	48.9
Corporation tax due	(-14 + 17 (v))	3.0
Preference dividend accrued	(vii)	1.1
Equity dividend due	(vi)	15.7
		147.1
Total equity & liabilities		**703.9**

Working (i) / note (i)
Labour and overheads directly attributable to the construction of new PPE should be capitalised.

	DR € million	CR € million
Dr Land & Buildings	3.5	
Cr Administration expenses		3.5

Interest directly attributable to the construction should likewise be capitalised.

	DR € million	CR € million
Dr Land & Buildings	1.2	
Cr Finance costs		1.2

Old buildings amounting to €114.6 million (131.6 – 17) need to be depreciated over 30 years. Charge €3.8 million to cost of sales.

	DR € million	CR € million
Dr Cost of sales	3.8	
Cr Accumulated depreciation – buildings		3.8

The new building is not depreciated as it is only ready to be brought into use on 31 July 2015.
Depreciation of plant & equipment amounting to €28 million [(168 - 56) * 25%] is charged to cost of sales.

	DR € million	CR € million
Dr Cost of sales	28.0	
Cr Accumulated depreciation – plant & equipment		28.0

Working (ii)
Goods sold on sale or return do not meet the IAS 18 requirement that the risk associated with the goods has been transferred to the new owner. Also, it is not yet probable that the economic benefit associated with earning revenue will flow to the seller. Hence we must reduce revenue and trade receivables by €22 million. The goods must be included in closing inventory at their cost price (€22 million * 70% - €15.4 million).

Reduce revenue and trade receivables:

	DR € million	CR € million
Dr Revenue	22.0	
Cr Trade receivables		22.0

Include goods at cost in closing inventory:

	DR € million	CR € million
Dr Inventory	15.4	
Cr Cost of sales		15.4

Working (iii)
According to IAS 38, internally generated intangibles may not be recognised in the financial statements as an asset unless there is an active market in identical assets. It is clear that a brand is unique, and therefore cannot form part of a population of identical assets. The existence of an estimate of fair value does not constitute sufficiently strong evidence of valuation.

Eliminate €30 million from intangible assets and revaluation reserve:

	DR € million	CR € million
Dr Revaluation reserve	30.0	
Cr Intangible assets		30.0

Working (iv)
Under IAS 37 a provision should be made as it is probable that an outflow of economic benefits will occur in aggregate. The best estimate of the cost of honouring the warranty is 120% of the selling price of 4% of our revenue for the last 12 months. This cannot include the goods on sale or return as we have entered into no contract for warranty in respect of these goods, hence there is no present obligation. As there is an existing provision in place, only the increase or decrease remains to be recorded.

Required provision: (1041.6 – 22) * 4% * 120%	48.94
Existing provision	(42.0)
Increase required	6.94

Record increase in provision for warranty:

	DR € million	CR € million
Dr Administration expenses	6.9	
Cr Provision for warranty		6.9

Working (v)

The existing balance is €14 million debit. The required provision is €3 million credit. Hence the total movement, and charge to profit or loss, is €17 million.

Adjust taxation provision:

	DR € million	CR € million
Dr Profit or loss - taxation	17.0	
Cr Taxation liability		17.0

Working (vi)

There are 39.2 million equity shares in issue (€196 million / €5 each). Hence the total dividend payable is 39.2 million * €0.40 = €15.68 million. As the proposal to pay this was made prior to the reporting date, a liability is recognised. As it is a transaction with owners, it is not an expense in the SPLOCI. It appears in the statement of changes in equity.

Accrue for equity dividend payable:	DR € million	CR € million
Dr Retained earnings	15.7	
Cr Equity dividends payable		15.7

Working (vii)

The preference shares were issued on 1 February 2015. Therefore 6 months dividend should be accrued. €56m * 4% * 6/12 = €1.12 million. As the preference shares are cumulative, they are classified as liabilities under IAS 32. Therefore the dividend is charged to finance costs within profit or loss and recognised as a liability. Also, the shares are themselves classified as non-current liabilities for the same reason.

Preference dividend accrued:	DR € million	CR € million
Dr Finance costs	1.1	
Cr Preference dividends payable		1.1

Working (viii)

A loss of €120 million is recognised. As the election was made to recognise such gains and losses as “other comprehensive income”, it is so classified. It is included within revaluation surplus, and deducted from financial assets.

Remeasurement loss on financial assets:	DR € million	CR € million
Dr OCI / revaluation surplus	120.0	
Cr Financial assets		120.0

SOLUTION 3

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

1 Answer **(b)**
Gross margin of 20% implies gross profit is €50 million. Net margin of 8% implies profit before interest and taxation is €20 million. The difference most likely consists of net operating expenses.

2. Answer **(c)**
ROCE is calculated by dividing profit before interest and tax (PBIT) by total capital employed (equity plus debt). Increasing the taxation charge will have no impact on PBIT, but will reduce capital employed (as the retained earnings, and therefore the equity figure will be reduced). Therefore, the result will be higher as a percentage of capital employed.

3. Answer **(c)**
Inventory days is the reciprocal of the inventory turnover ratio. A turnover of 14 times implies an average holding period of 365 / 14 or 26 days.

4. Answer **(c)**
ROCE is the product of the net margin and asset turnover ratios. As we know two of these, it is easy to work out the third. 12% = 8% * 150%.

5. Answer **(d)**
Publicly quoted entities must use IFRS, hence cannot choose to use FRS 100-102. Therefore answers (a), (b) and (c) are incorrect.

6. Answer **(c)**
IAS 2 *Inventory* requires that inventory items be carried at the lower of cost or net realisable value (NRV). If an item will be incorporated into a further product, the NRV of this product may be used instead of the NRV of the individual inventory item.

Here, the cost of the raw material is €30,000. The NRV of the raw material is €19,000. However the NRV of the completed product in its current state is €75,000 – 25,000 = €50,000. This is in excess of its cost, hence the appropriate accounting value for the raw material is its cost, €30,000.

7. Answer **(a)**
Under IAS 33 *Earnings per Share*, basic earnings per share (EPS) is calculated as profit for the period. This is by definition after taxation and before other comprehensive income.

Hence EPS is (45 – 8) / 30 or €1.23

8. Answer **(a)**
Meeting any one of the three quantitative tests mentioned is sufficient in order for a segment to be considered reportable. Hence answer (a) is the untrue statement. Each of the other statements is true under IFRS 8 *Operating Segments*.

SOLUTION 4
Marking Scheme:

(a)	Purpose & aims of conceptual framework (3 points plus discussion / explanation)	6
	Status of conceptual framework (3 relevant points at 1 mark each)	4
	Subtotal	10
(b)	At least 5 advantages and disadvantages mentioned and discussed in sufficient depth to demonstrate understanding (2 marks per point made and discussed).	10
	Subtotal	10
	Total	20

Suggested Solution:

(a) Purpose & Aims of the Conceptual Framework

The Conceptual Framework was designed to set out fundamental concepts that underlie the preparation and presentation of financial statements. The following represent some of the core reasons for the development of the framework:

- To assist the IASB in developing and amending standards. Without a framework such as this, standards have been developed in an ad-hoc manner. This has not always resulted in top quality standards that are consistent with each other.
- To reduce the number of alternative accounting treatments permitted by IFRS. A feature of older standards has been the development of a "recommended" treatment and an "allowed alternative". This may have been for political reasons, such as to avoid conflicts with national laws, or to encourage acceptance of the standards by a wider constituency. However it led to weaker standards, and inconsistency in application.
- To assist other standard setters in developing standards. Not all national standard setters have the resources or expertise to ensure theoretically sound standards. The existence of a generally accepted high-quality framework provides support to these and similar bodies.
- To provide guidance to preparers and auditors in applying and assessing application of IFRS, especially in "grey" areas where the guidance in IFRS is absent or ambiguous.
- To assist users of financial statements interpret information presented.

Status of Conceptual Framework

- The Conceptual Framework in not an IFRS, and does not seek to provide guidance on any specific accounting transaction.
- The Framework is meant to set out high-level principles which seek to guide and inform the application of the standards. The standards are effectively more detailed applications of the principles in the Framework.
- It is recognised that the Framework is much younger than many standards and that there may be contradictions between it and some standards. The Framework does not overrule any IFRS. If there is a conflict, the IFRS prevails.
- It is anticipated that as the Framework and IFRS evolves, the number of conflicts will decline.

(10 marks)

(b) **Advantages:**

- It brings a measure of consistency to the development of new standards.
- Standards are more likely to be developed based on conceptual merits rather than on the basis of economic consequences.
- It prevents arguments over the same conceptual points recurring as each standard is being developed.
- It provides support for objective standard setters against those who would seek to influence standards to suit sectional or vested interests.
- It is likely that global adoption of IFRS would be higher due to higher quality and more consistent standards.
- It makes it easy to highlight anomalies and inconsistencies in standard setting.

Disadvantages:

- It can be difficult to develop a set of principles that are applicable fairly to every situation.
- Different parts of the world with different economic and cultural norms may need different principles. This may serve to limit the global adoption of IFRS.
- Economic consequences of accounting standards may be ignored.
- The principles in the framework are by necessity general and subject to interpretation.
- Many areas of accounting that could benefit from general principles are not covered in the Conceptual Framework. An example is the recognition of gains or losses through profit or loss or other comprehensive income, which is somewhat arbitrary at present.

(10 marks)

[Total: 20 MARKS]

SOLUTION 5

(a)

(i) Definition of an Accounting Policy:
Accounting policies are the specific principles, bases, conventions, rules and practices applied by an entity in preparing and presenting financial statements.

When an IAS/ IFRS (or an Interpretation) specifically applies to a transaction, other event or condition, the accounting policy or policies applied to that item shall be determined by applying the Standard or Interpretation and considering any relevant Implementation Guidance issued by the IASB for the Standard or Interpretation.

An entity shall select and apply its accounting policies consistently for similar transactions, other events and conditions, unless a Standard or an Interpretation specifically requires or permits otherwise.

The use of reasonable estimates is an essential part of the preparation of financial statements and does not undermine their reliability. Examples include: Bad debts, inventory obsolescence, fair values of assets, useful lives of assets, warranty obligations. A change in accounting estimate is an adjustment of the carrying amount of an asset or a liability, or the amount of the periodic consumption of an asset, that results from the assessment of the present status of, and expected future benefits and obligations associated with, assets and liabilities.

(4 marks)

(ii) Change of Accounting Policy:
An entity shall change an accounting policy only if the change:

- Is required by a Standard or an Interpretation; or if it
- Results in the financial statements providing reliable and more relevant information about the effects of transactions, other events or conditions on the entity's financial position, financial performance or cash flows.

An entity shall account for a change in accounting policy resulting from the initial application of a Standard or an Interpretation in accordance with the specific transitional provisions, if any, in that Standard or Interpretation. Where this does not apply, the entity shall apply the change retrospectively. This means that the accounts must be altered so that they contain the numbers which would have been there had the new policy always been in force. However, this will not apply if it is impracticable to determine either the period-specific effects or the cumulative effect of the change. The initial application of a policy to revalue assets is not dealt with in this manner.

Change of Accounting Estimate:
accordingly, are not corrections of errors. The effect of a change in an accounting estimate, shall be recognised prospectively (i.e. from the date of the change onward) by including it in profit or loss in the period of the change and future periods, if relevant.

Correction of Prior Period Errors :
Prior period errors are omissions from, and misstatements in, the entity's financial statements for one or more prior periods arising from a failure to use, or misuse of, reliable information that:

- Was available when financial statements for those periods were authorised for issue; and
- Could reasonably be expected to have been obtained and taken into account in the preparation and presentation of those financial statements.

Examples of such errors include the effects of mathematical mistakes, mistakes in applying accounting policies, oversights or misinterpretations of facts, and fraud.

Except to the extent that it is impracticable to determine either the period-specific effects or the cumulative effect of the error, an entity shall correct material prior period errors retrospectively in the first set of financial statements authorised for issue after their discovery. This means that the accounts must be altered so that they contain the numbers which would have been there had the error never occurred. The following actions must be taken:

- Restate the comparative amounts for the prior period(s) presented in which the error occurred; or
- If the error occurred before the earliest prior period presented, restate the opening balances of assets, liabilities and equity for the earliest prior period presented.
- Adjust the opening balance in the statement of changes in equity.

Omissions or misstatements of items are material if they could, individually or collectively, influence the economic decisions of users taken on the basis of the financial statements.

(6 marks)

(b) The effect of the fraud existed in previous periods although the directors of Sigma plc were unaware of it. Hence, the financial statements should be corrected retrospectively. As the current financial statements will show one comparative year, both of these years will be restated. Any effect predating the earliest period presented will be adjusted for through opening equity balances. The incremental effects of the fraud will be reported through profit or loss each year, appearing as additional expenses. The cumulative effects will appear in the Statement of Financial Position, through a reduction of the trade receivables and retained earnings figures. The opening equity balances in the statement of changes in equity should show the original balance, adjusted by the cumulative effect of the adjustment. This is so users can reconcile the figures with those published the previous year.

Statements of Profit or Loss and Other Comprehensive Income for year ended 31 July:

	2015	**2014**
	€'000	**€'000**
Revenue	300	275
Cost of Sales	(225)	(212)
Gross Profit	75	63
Expenses	(50)	(42)
Profit for year	25	21

Statements of Changes in Equity (Retained Earnings only) for year ended 31 July:

	2015	**2014**
	€'000	**€'000**
Balance 1 August	258	236
Prior period adjustment	(30)	(14)
Adjusted opening balance	228	222
Profit for the year	25	21
Dividends declared	(16)	(15)
Balance 31 July	237	228

Statements of Financial Position as at 31 July:

	2015	**2014**
	€'000	**€'000**
Non-current Assets	294	306
Current Assets	93	72
	387	378
Equity Share Capital	150	150
Retained Earnings	237	228
	387	378

(10 marks)

[Total: 20 Marks]