CPA IRELAND | CERTIFIED PUBLIC ACCOUNTANTS

CORPORATE REPORTING

PROFESSIONAL 1 EXAMINATION - AUGUST 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. Mizzell Plc (Mizzell) is a public limited company based in Ireland. It has shareholdings in two other companies, Buckley Plc (Buckley) and Feeney Plc (Feeney). Statements of financial position are shown below for all three companies as at 31 July 2016.

Statements of Financial Position as at 31 July 2016

	Mizzell Plc € million	Buckley Plc € million	Feeney Plc € million
Non-current assets			
Property, plant & equipment	1,170	55	155
Intangible assets	268	120	47
Investments in group companies at cost	167		
Financial assets	190	32	7
	1,795	207	209
Current assets:			
Inventories	220	142	31
Trade receivables	330	79	37
Cash & bank	140	49	9
	690	270	77
Total assets	**2,485**	**477**	**286**
Equity:			
Equity share capital of €2.00 each	1,190	200	100
Capital reserves	350	80	20
Retained earnings	358	65	61
	1,898	345	181
Non-current liabilities:			
6% loan notes	100		
Contingent consideration	12		
Obligations under finance leases	243		
	355		
Current liabilities:			
Trade and other payables	186	94	75
Current taxation	46	38	30
Total liabilities	232	132	105
Total equity & liabilities	**2,485**	**477**	**286**

The following additional information may be relevant:

(i) Mizzell bought 60 million ordinary shares in Buckley on 1 August 2014, when the capital reserves of Buckley were €60 million and the retained earnings of Buckley were €40 million. The consideration was agreed at €155 million in cash on the date of purchase, plus a contingent payment of €25 million to be paid on 1 August 2016, provided profits after tax were at least €25 million per year on average. The fair value of the contingent consideration was estimated at €12 million at the acquisition date, and this amount was capitalised as part of the cost of investment in accordance with IFRS 3 - *Business Combinations*. This estimate was unchanged at 31 July 2015. However, significant losses were incurred by Buckley in the year to 31 July 2016. Consequently nothing will be payable on 1 August 2016 under this part of the deal.

(ii) The group accounting policy is to value any Non-Controlling Interests (NCI) at their fair value at the acquisition date. On the date Mizzell acquired its interest in Buckley, the fair value of the NCI in Buckley was €120 million.

(iii) On 1 August 2014, the intangible assets held by Buckley had a fair value €25 million in excess of their carrying value. These assets had a useful remaining economic life of 5 years at the date of acquisition.

(iv) Mizzell bought a 40% holding in the ordinary shares of Feeney on 1 August 2015, when the capital reserves of Feeney were €20 million and the retained earnings balance in Feeney's books stood at €65 million. The consideration consisted of equity shares issued by Mizzell on a 2 for 5 basis. The fair value of Mizzell's equity shares on 1 August 2015 was €6.50 each. The share issue has not yet been recorded by Mizzell. Mizzell exerts significant influence over Feeney as a result of this holding.

(v) During the financial year ended 31 July 2016, Buckley had sold goods to Mizzell amounting to €18 million. The purchase price included a margin of 20%. Of these goods, one-third remained in the closing inventory of Mizzell at the reporting date.

(vi) The amount carried under the heading "Obligations under finance leases" in the books of Mizzell consists of the total obligation under finance leases correctly calculated under IAS 17 - *Leases*. However, on review, it has become clear that €66 million in finance lease payments will be payable on 31 July 2017. The interest rate implicit in the finance leases averages 10%.

(vii) No dividends were paid or proposed in the year to 31 July 2016 by any group company.

(viii) No impairment losses were deemed necessary at 31 July 2015 or 2016.

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

REQUIREMENT:

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

Format & Presentation (1 mark)

(b) How would the initial calculation and subsequent treatment of goodwill arising on the acquisition of Buckley have differed had the consolidated statement of financial position been prepared under FRS 102. You are not required to redraft the statement in answer to this requirement. The cost of capital for the group can be taken to be 10%.

(6 marks)

[Total: 30 MARKS]

2. The following draft Statement of Financial Position was drawn up as at 31 July 2016 on the instructions of the directors of Bedrock Plc. On subsequent examination of the books and records the finance director has prepared a list of issues which she believes may require amendments to the draft statement presented.

Bedrock Plc: Statement of Financial Position as at 31 July 2016

			€ million
Non-current assets:			
Land & buildings			420
Plant & equipment			600
Investment property			120
Equity investments			360
			1,500
Current assets:			
Inventory			80
Trade receivables			125
Cash & bank			30
			235
Total assets:			**1,735**
Equity:			
Equity share capital			400
Share premium			200
Retained earnings:	Balance 1 August 2015	375	
	Profit for year	95	
	Dividend declared	(30)	440
Other components of equity:	Balance 1 August 2015	128	
	Other comprehensive income for year	35	163
			1,203
Non-current liabilities:			
Finance lease obligations			175
5% debenture 2020			150
			325
Current liabilities:			
Trade payables			110
Finance lease obligations			35
Provision for warranty claim			12
Corporation tax due			20
Final dividend due			30
			207
Total equity & liabilities			**1,735**

The following notes are to be taken into account in so far as they are relevant:

(i) Land and buildings are carried after charging depreciation for the year. On 31 July 2016, a piece of property, carried at €130 million, was revalued to €110 million. This revaluation has not been accounted for. The revaluation reserve (included with other components of equity) had a balance of €12 million due to previous revaluations of this property.

(ii) Plant and equipment are carried after charging depreciation for the year. A sale agreement was entered into during July 2016 to sell some of this plant. The plant sold had a carrying value of €45 million at the date of sale and was sold for an agreed price of €39 million. No cash has yet been received in respect of this sale, as a 30-day credit period was agreed with the purchaser. No entry has been made to record this transaction.

(iii) The above figure for investment properties does not take account of the results of a fair valuation exercise carried out on 31 July 2016. The result of this was that the investment properties had a fair value of €125 million at that date. Bedrock Plc adopts the fair value model for investment properties.

(iv) The equity investments had a fair value of €380 million at 31 July 2016, which has not yet been incorporated into the financial statements. Bedrock has made an election to take all fair value gains and losses on equity investments to “other comprehensive income” as permitted by IFRS 9 - *Financial Instruments*.

(v) The 5% debenture was issued on 1 August 2015 for cash proceeds of €150 million, and was correctly recorded. The redemption terms of this debenture are such that the effective rate of interest to maturity was 6.5%. The only other entry made in respect of the debenture was the payment of €7.5 million interest on the due date 31 July 2016.

(vi) Bedrock Plc offers a 12-month warranty on all goods sold to retail customers. A provision is maintained for the expected cost of honouring this warranty. This has not been updated as at 31 July 2016. Bedrock sold 40,000 units of its relevant product during the year, all of which qualify for warranty. It expects 10% of these to need minor repairs at an average cost of €500 each, and 3% to need major repair at a cost of €10,000 each. All costs are expected to be incurred within 12 months.

(vii) Ignore the taxation effects of any adjustments you make.

REQUIREMENT:

(a) Prepare a schedule showing any corrections required to the profit and other comprehensive income for the year.

(8 marks)
Format & Presentation (1 mark)

(b) Redraft the Statement of Financial Position at 31 July 2016 taking the above into account. (12 marks)
Format & Presentation (1 mark)

(c) Assess the key differences between operating leases and finance leases. (8 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. Under IAS 8 - *Accounting Policies, Changes in Accounting Estimates and Errors*, which of the following are considered changes of accounting policy?

   (i) Changing the useful economic life estimate for a piece of plant.

   (ii) Classifying depreciation on plant under 'cost of sales' in the Statement of Profit or Loss and Other Comprehensive Income, having previously classified it under 'administration expenses'.

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

2. IAS 37 - *Provisions, Contingent Liabilities and Contingent Assets* requires a liability to be recognised in which of the following situations?

   (i) A detailed plan for a reorganisation has been agreed at board level, prior to the reporting date. This will involve the future payment of €3 million in redundancy costs. No announcement of this reorganisation has been made at the reporting date.

   (ii) A customer was injured on the company's premises prior to the reporting date, and has sued for €1 million. Although the case has yet to come before the courts, legal advice has been received to the effect that the company is likely to be found liable.

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

3. Under IAS 2 - *Inventories* what should be the total carrying value of the items of inventory below?

	Item "A"	**Item "B"**
Number of units in closing inventory	200	100
Production cost per unit	€15	€20
Expected selling price per unit	€20	€28
Selling costs per unit	€8	€3

   (a) €5,000;
   (b) €4,900;
   (c) €4,400;
   (d) None of the above.

4. On 1 August 2015 the following costs were incurred in connection with the purchase of an item of plant:

	€ million
• Invoiced purchase cost of plant	17.5
• Delivery, installation and commissioning	1.8
• Decommissioning and disposal costs of old plant	0.5
• Redundancy payments to surplus staff as a result of new plant	2.0

   Which of the following amounts should be capitalised under IAS 16 - *Property, Plant and Equipment*?

   (a) €17.5 million
   (b) €19.3 million
   (c) €19.8 million
   (d) €21.8 million

5. Gresham Plc bought a ten-year bond on 1 August 2015 at a cost of €45 million. The bond carries an interest coupon of €4 million paid annually in arrears, and its effective yield to maturity was 12% at the date of purchase. Gresham is holding the bond as a speculative investment, expecting its value to increase, and hopes to sell the bond at a profit in the short to medium term. On 31 July 2016, its reporting date, the fair value of the bond had declined to €43 million. The interest payment was received as scheduled.

How much should be recognised in profit or loss as a result of the above, and what should be the carrying value of the bond at the reporting date of 31 July 2016 under IFRS 9 - *Financial Instruments*?

	Profit or Loss	**Carrying value**
(a)	€5.4 million gain	€46.4 million
(b)	€4 million gain	€45 million
(c)	€2 million gain	€43 million
(d)	€2 million loss	€43 million

6. On 1 August 2015 the consolidated net assets of Fergal Plc included €35 million relating to a 100% owned subsidiary, Kevin Plc. Goodwill on the acquisition of Kevin was carried at €12 million in addition to this figure. During the year ended 31 July 2016, Kevin Plc earned total comprehensive income of €6 million. On 31 January 2016, Fergal sold the entire share capital of Kevin for €45 million. Under IFRS 10 - *Consolidated Financial Statements* how much is the consolidated gain or loss on disposal of the shares in Kevin? Ignore taxation and assume results are generated evenly throughout the year.

(a) €8 million loss
(b) €5 million loss
(c) €2 million loss
(d) None of the above.

7. Ultan Plc entered into a finance lease on 1 August 2015 under which it agreed to make 4 annual payments of €15 million in advance. The fair value of the plant leased, and the present value of the minimum lease payments was €48.5 million and the useful economic life was 5 years. The interest rate implicit in the lease was 10%.

How much should be charged to Profit or Loss for year ended 31 July 2016 under IAS 17 - *Leases* (to one decimal place)?

(a) €15.5 million
(b) €15.0 million
(c) €17.0 million
(d) None of the above.

8. On 1 August 2015 Charlie Plc, whose functional currency is the euro, bought a property in a foreign country for US$40 million. The property had a 20-year useful economic life with no residual value estimated. On 31 July 2016 the property was revalued to US$45 million. Exchange rates were:

1 August 2015	€1 = US$ 1.25
31 July 2016	€1 = US$ 1.125

Under IAS 21-*The Effects of Changes in Foreign Exchange Rates* and IAS 16 - *Property, Plant & Equipment* how much should be recognised within Profit or Loss and Other Comprehensive Income for year ended 31 July 2016?

	Profit or Loss	Other Comprehensive Income
(a)	€2 million loss	€5 million gain
(b)	€1.6 million loss	€8 million gain
(c)	€1.6 million loss	€9.6 million gain
(d)	nil	€8 million gain

[Total: 20 Marks]

Answer *either* Question 4 *or* Question 5

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

The following figures appeared in the Consolidated Statement of Profit or Loss and Other Comprehensive Income of Jakarta Plc for year ended 31 July 2016, together with comparatives for 2015:

	€ million 2016	**€ million 2015**
Profit before taxation	400	300
Taxation on profit	(75)	(60)
Profit for the period	325	240
Other comprehensive income – revaluation gains on land	30	10
Total comprehensive income for the period	355	250
Profit for the year attributable to:		
Owners of the parent	280	210
Non-controlling interests	45	30
Profit for the year	325	240
Total comprehensive income for the year attributable to:		
Owners of the parent	310	220
Non-controlling interests	45	30
Total comprehensive income for the year	**355**	**250**

The following figures are taken from Jakarta's Statement of Financial Position as 31 July 2016, together with comparatives:

	€ million 2016	**€ million 2015**
Equity share capital of €0.50 each	460	200
4% Preference shares – non-redeemable, non-cumulative	100	100
Share premium	215	60
Retained earnings	688	570
Other equity reserves	90	60
Non-controlling interests	85	40
Total equity	1,638	1,030

During the year ended 31 July 2016 the following changes took place to the issued share capital of Jakarta Plc:

(i) 100 million equity shares were issued in conjunction with the acquisition of another business. These were issued at full market price at the date of issue, 1 November 2015.

(ii) 150 million ordinary shares were issued for cash to existing shareholders on 1 February 2016. The issue price was €1.50 per share, which represented a discount of 25% on the traded price immediately before the issue of (€2.00).

(iii) On 31 July 2016, a bonus issue of 270 million shares was completed, capitalising €135 million of retained earnings. Also on this date the preference dividend due for the year, and an equity dividend of €23 million, were paid.

REQUIREMENT:

(a) Discuss the significance of the earnings per share (EPS) figure to the analysis of company performance. Why is it important to have an accounting standard in this area?

(6 marks)

(b) Applying the requirements of IAS 33 - *Earnings Per Share* to the information above, calculate the basic EPS for year ended 31 July 2016 and the comparative figure for 2015 to be reported in the 2016 financial statements. The EPS figure originally reported in 2015 was €0.525.

(14 marks)

[Total: 20 MARKS]

OR

5. Under the IASB's *Conceptual Framework for Financial Reporting* certain qualitative characteristics of useful financial information are identified. These are subdivided into characteristics considered fundamental and those considered to be enhancing. The two fundamental characteristics identified by the framework are 'relevance' and 'faithful representation'. In order for financial transactions to be represented faithfully in the financial statements, the principle of 'substance over form' should be applied. This means that wherever there is a difference between the legal form of a transaction and its economic substance, the financial statements should reflect the economic substance.

The following transactions were entered into by Rolojet Plc (Rolojet) during the year ended 31 July 2016:

(i) On 1 August 2015, Rolojet agreed to sell a plot of land to another entity for €5 million cash. The land had a carrying value and a fair value at that date of €4 million. On the same date Rolojet entered into a binding agreement with the same counterparty to repurchase the land on 1 August 2016 for €5.5 million cash.

(ii) On 1 July 2016, Rolojet delivered goods with an invoice value of €400,000 to a customer. The agreement with the customer was that the goods would be paid for only if the customer sold them on. If they were not sold by 31 August 2016, the customer could pay for them, or return them without penalty. Rolojet could request the return of the goods at any time until the customer paid for them. The goods had cost Rolojet €340,000 to manufacture. On 31 July 2016, none of the goods had been paid for by the customer, and none returned.

(iii) On 10 July 2016, Rolojet delivered goods with an invoice value of €250,000 to another customer. The agreement with this customer was that the goods would be paid for on sale to a third party or on 31 August 2016. However, in this case there was no right of return once the customer accepted delivery and was satisfied the goods were as ordered and of good quality. The goods had cost Rolojet €160,000 to manufacture. On 31 July 2016, none of the goods had been paid for by the customer.

REQUIREMENT:

(a) Why it is considered important that the economic substance of a transaction be reflected in the financial statements over its legal form?

(4 marks)

(b) Describe in general terms the features of a transaction that suggest that its economic substance may differ from its legal form.

(4 marks)

(c) In the case of (i) to (iii) above, explain using journals, how the transactions should be accounted for under IFRS, justifying for your answers. Assume no entries have already been made in respect of the above transactions.

(12 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% Mizzell + 100% Buckley)	3
	Calculation and treatment of negative goodwill (including NCI at acquisition date)	3
	Investment in associate calculation and subsequent movement	3
	Fair value adjustments and post acq movements	2
	Intra group sales of inventory	2
	Calculation and movement of lease between current and non-current liabilities	3
	Reserves calculation and consolidation - both	5
	NCI calculation at reporting date	2
	Presentation	1
	Subtotal	**24**
(b)	Explanation and calculation of difference in initial calculation	4
	Explanation and calculation of difference in treatment of negative goodwill	2
	Subtotal	**6**

[Total: 30 Marks]

SUGGESTED SOLUTION

(a)
Group structure:
Mizzell owns 60 million shares out of 100m in Buckley. This gives 60% ownership in Buckley for 2 full years therefore Buckley is a subsidiary. Note the equity shares are of €2 nominal value.
Mizzell has 40% ownership in Feeney for the full year and can exert significant influence. Therefore, Feeney is an associate of Mizzell.

Mizzell plc: Consolidated statement of financial position of as at 31 July 2016

	€ million
Non current assets:	
Property, plant and equipment (1,170 + 55)	1,225.0
Intangible assets (268 + 120 +15 (W6)	403.0
Investment in Associate (W5)	50.4
Financial Assets (190 + 32	222.0
	1,900.4
Current assets:	
Inventories (220 + 142 - 1.2 (W7)	360.8
Trade receivables (330 + 79)	409.0
Cash & bank (140 + 49)	189.0
	958.8
Total assets	**2,859.2**
Equity:	
Equity shares 1,190 + 16 (W5)	1,206.0
Capital reserves (W3)	398.0
Retained earnings (W2)	414.7
	2,018.7
Non-controlling interest (W4)	133.5
	2,152.2
Non-current liabilities:	
6% loan note	100.0
Contingent consideration (12 - 12 (W1)	0.0
Obligations under finance leases (243 - 60 (W8)	183.0
	283.0
Current liabilities:	
Trade payables (186 + 94)	280.0
Obligations under finance leases (W8)	60.0
Current taxation (46 + 38)	84.0
	424.0
Total equity & liabilities	**2,859.2**

W1

Calculation of goodwill on acquisition of Buckley		**€ million**
Consideration		
Cash		155
Contingent consideration (fair value at acquisition date)		12
		167
Value of NCI (note (iii))		120
FV of net assets acquired		
Equity share capital	200	
Capital reserves	60	
Retained earnings	40	
Fair value adjustment – intangible assets	25	
		(325)
Goodwill		(38)
Credit to retained earnings		38
Balance		0

Note:

(1) Negative goodwill is credited entirely to group retained earnings as a gain on bargain purchase under IFRS 3.

(2) The contingent consideration is recognised at fair value at the acquisition date, and the fair value estimate is updated annually through profit or loss. At 31 July 2016 is is clear that this will not be paid. Hence we will credit retained earnings, and eliminate the liability from the books.

W2

Group retained earnings at 31 July 2016	**Mizzell € million**	**Buckley € million**
Balance per SOFP (total at y/e)	358	65
Less balance at acquisition (note (i))		(40)
Elimination of negative goodwill (W1)	38	
Elimination of contingent consideration (W1)	12	
Share of loss of associate (W5)	(1.6)	
Amortisation of FVA intangible assets (W6)		(10)
URP in inventory re intra-group sale of goods to Mizzell (W7)		(1.2)
Adjusted reserves for consolidation	406.4	13.8
Consolidate Buckley (60% * 13.8)	8.3	
Group total	414.7	

W3

Group capital reserves at 31 July 2016	**Mizzell € million**	**Buckley € million**
Balance per SOFP (total at y/e)	350	80
Less balance at acquisition (note (i))		(60)
Share premium on shares issued to acquire Feeney (W5)	36	
Adjusted reserves for consolidation	386	20
Consolidate Buckley (60% * 20)	12	
Group total	398	

W4

Non-controlling interest at 31 July 2015	**Buckley € million**
Balance at acquisition (W1)	120
Share of post-acquisition retained earnings from W2 (40% * 13.8)	5.5
Share of post-acquisition capital reserves from W3 (40% * 20)	8
Total	133.5

W5

Investment in Associate	**Feeney € million**
Balance at acquisition (note (ii))	
Equity shares issued (not recorded yet) 50 * 40% * 2/5 * €6.50	52
Share of post-acquisition retained earnings 40%*(61 - 65)	(1.6)
Share of post acquisition capital reserves: 40% * (20 – 20)	0
Total	50.4

Tutorial note:

There are 50 million shares in Feeney (remember €2 nominal value!!), of which Mizzell purchased 40%, or 20 million. For these, Mizzell issued 2 of its own shares for every 5 acquired. Hence, Mizzell issued 8 million of its shares. As these were not recorded, we must do so now. Share capital will be credited with €16 million (€2 per share) and share premium with (52 – 16) €36 million.

As retained earnings declined since Mizzell's purchase, it must take a charge for its share of the losses. This reduces retained earnings and the value of the investment in the associate.

W6

Fair value adjustments (note (iii):

	At acquisition	**Movement**	**At rep. date**
Intangible assets - Buckley	€25m	(€10m)**	€15m

**Movement = amortisation of the adjustment for 2 full years since acquisition: €25m / 5 yrs * 2 yrs = €10m. This is charged to the earnings of the company which holds (and therefore depreciates) the asset, namely Buckley. Hence:

Dr Intangible assets	€15.0m	
Dr Retained earnings – Buckley	€10.0m	
Cr Goodwill (FV net assets)		€25.0m

W7

Intra-group trading of goods (note (v))

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

€18 million * 20/100 * 1/3 (sold by Buckley therefore NCI IS affected) €1.2m

Adjustment to reduce reserves (Buckley) and Inventory:

Dr Retained Earnings (Buckley)	€1.2m	
Cr Inventory		€1.2m

W8

Reclassification of finance lease obligation (note (vi))

Finance lease obligations due within 12 months must be classified as current liabilities rather than non-current liabilities. Lease obligations are carried net of future interest charges. Hence the amount due on 31 July 2017 of €66 million must be stated at its present value at 31 July 2016. This is 66 / (1.10) or €60 million. This amount should be reclassified from non-current liabilities to current liabilities.

(b) Under FRS 102 there are two differences in the calculation of goodwill is calculated in this question:

Firstly, goodwill is calculated under the partial method only.
Secondly, the contingent consideration is measured based on whether or not it is probable that the amount will become payable. This is an "all or nothing" approach, as distinct to the IFRS approach of using the fair value. The fair value would incorporate the probability that it may become payable.

If it is deemed probable, the entire amount is recognised, but discounted to reflect the time value of money. This discount is unwound through profit or loss as time passes.

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

		€ million
Consideration		
Cash		155
Contingent consideration (present value at acquisition date = €22m / $(1.1)^2$)		18.2
		173.2
Value of NCI (€325m * 40%)		130
FV of net assets acquired		
Equity share capital	200	
Capital reserves	60	
Retained earnings	40	
Fair value adjustment – intangible assets	25	
		(325)
Goodwill		(21.8)

As the goodwill figure is negative, the following procedure applies:

1. Reassess the identification and measurement of Buckley's identifiable net assets at acquisition;
2. Assuming no change is identified, show the negative goodwill on the face of the statement of financial position immediately below the existing line for goodwill, as a negative asset;
3. Amortise this balance to profit or loss during the periods over which the non-monetary assets acquired are recovered.

SOLUTION 2

Marking Scheme:

(a)	Statement of corrected 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 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**
(c)	Lease	
	3 key differences fully explained at 2 marks each	6
	Subtotal	**6**

[Total: 30 Marks]

SUGGESTED SOLUTION

(a) Schedule of changes to profit and OCI for the year

		Profit for year € million	OCI for year € million
Figures per draft financial statements		95	35
Revaluation of property	W1	(8)	(12)
Loss on disposal of plant	W2	(6)	
Gain in fair value of investment properties	W3	5	
Gain in fair value of equity investments	W4		20
Additional finance cost	W5	(2.25)	
Additional warranty provision	W6	(2)	
Adjusted figures		81.75	43

(b) Redrafted statement of financial position

Bedrock plc: Statement of Financial Position as at 31 July 2016 (redrafted)

			€ million
Non-current assets:			
Land & buildings (420 – 20 W1)			400
Plant & equipment (600 – 45 W2)			555
Investment property (120 + 5 W3)			125
Equity investments (360 + 20 W4)			380
			1,460
Current assets:			
Inventory			80
Trade and other receivables (125 + 39 W2			164
Cash & bank			30
			274
Total assets:			**1,734**
Equity:			
Equity share capital			400
Share premium			200
Retained earnings:	Balance 1 August 2015	375	
	Profit for year	81.75	
	Dividend declared	(30)	426.75
Other components of equity:	Balance 1 August 2015	128	
	Other comprehensive income for year	43	171
			1,197.75
Non-current liabilities:			
Finance lease obligations			175
5% debenture 2020 (150 + 2.25 W5)			152.25
			327.25
Current liabilities:			
Trade payables			110
Finance lease obligations			35
Provision for warranty claim (12 + 2 W6)			14
Corporation tax due			20
Final dividend due			30
			209
Total equity & liabilities			**1,734**

Workings:

W1 – Land & Buildings

This piece of property should be revalued downwards by €20 million (130-110). A downward revaluation in an IAS 16 (Property Plant & Equipment) asset should be charged to the revaluation reserve (and OCI) to the extent that a balance exists in that reserve relating to the same asset. Here, this amount is €12 million. Any further revaluation loss should be charged to profit or loss. The extra €8 million of loss should be so charged.

W2 – Plant & Equipment

This transaction should be recorded as a sale as the agreement has been made, and all significant economic risks and rewards associated with the plant have been transferred to the new owner. Hence a loss on disposal of €6 million (39-45) will be recorded in profit or loss. €45 million will be derecognised from PPE, and a receivable of €39 million recorded in current assets.

W3 – Investment Properties

Under the fair value model of IAS 40, investment properties should be revalued to fair value at each reporting date. Any adjustment is recognised in profit or loss. Hence the fair value increase of €5 million (125 – 120) should be shown in profit or loss as well as being reflected in the investment properties balance.

W4 – Equity Investments

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 Bedrock, hence the gain in value of €20 million (380 – 360) should be taken to OCI as well as being reflected in the carrying value of the equity investments.

W5 – Debenture

Under IFRS 9 the amortised cost method is appropriate for this liability as there is no evidence to suggest the company is treating the liability as a trading instrument. Hence the annual finance charge should reflect the effective rate to maturity rather than the coupon rate. The correct finance cost should therefore be €150m * 6.5% = €9.75 million instead of the recorded €7.5 million. The additional €2.25 million (9.75 – 7.5) should be charged as a finance cost to profit or loss and accrued as an additional non-current liability.

W6 – Warranty provision

The current liability for warranty provision needs to be updated at each reporting date to reflect best estimates available at that date. At 31 July 2016 best estimates suggest a provision of €14 million is required, calculated as follows:

Minor repairs: (4,000 * €500)	€2 million
Major repairs: (1,200 * €10,000)	€12 million
	€14 million

As the existing provision is recorded at €12 million, an additional charge of €2 million must be made to bring the provision up to the required €14 million.

This should be charged to profit or loss, and added to the existing provision.

(c) Differences between operating and finance leases:

A finance lease is one that transfers substantially all the risks and rewards of ownership attaching to the leased asset to the lessee. This is in substance considered equivalent to a purchase of the asset together with a loan to finance the purchase. IAS 17 requires that such contracts be accounted for as if they were purchases and loans, requiring the asset to be recognised in the books together with a corresponding loan liability. The asset needs to be depreciated, and the liability amortised with interest charged in accordance with the rate implicit in the agreement

An operating lease is any lease that does not meet the definition of a finance lease. This is essentially an asset rental agreement in substance.

Several criteria are suggested by IAS 17 as useful to help judge whether a lease is or is not a finance lease.

Some of these are:

- If the lease term is for substantially all the useful life of the asset, it is likely to be a finance lease.
- If the lease payments (at present value) amount to substantially all the fair value of the asset at inception, it is likely to be a finance lease.
- If the asset is highly specialised, with little or no resale or aftermarket value, it is more likely to be a finance lease.
- IF the terms of any secondary lease make it highly likely that it will be entered into, it is likely to be a finance lease.
- If any buyout terms are highly attractive to the lessee this supports the argument that the lease is a finance lease.

SOLUTION 3

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

1 **Answer (b)**

Changing the useful economic life estimate is considered a change of estimate, not of policy.
Changing the place of presentation of a number is considered a change of policy.
Hence, (ii) only is a change of accounting policy.

2. **Answer (b)**

In order for a provision for reorganisation to be made a detailed formal plan must be drawn up AND this must be communicated to relevant parties. No announcement has been made in this case.
As the event causing the potential loss has occurred prior to the reporting date, the present obligation exists at that date. A probable outflow of economic benefits will occur according to our legal advice. We also have an estimate of the amount of loss.
Hence, (ii) causes the recognition of a provision, (i) does not.

3. **Answer (c)**

Each item is assessed individually regarding its carrying value. The lower of cost or net realisable value is calculated, and the resulting amounts added. Net realisable value is calculated as the expected selling price less expected costs of sale. Hence this is €12 per unit for item "A" and €25 per unit for item "B". Item "A" is valued at its NRV (200 * €12 = €2,400), whilst item "B" is valued at its cost (100 * €20 = €2,000). Total valuation €4,400.

4. **Answer (b)**

Any direct costs considered necessary to bring the new asset to the condition and location where it can be brought in to productive use should be capitalised. This includes delivery, installation and commissioning. It does not include ancillary or consequential costs such as losses or costs of disposing of old plant, or redundancy costs of surplus staff.

5. **Answer (c)**

As the bond is not to be held to maturity it fails the "Business Model" test set out by IFRS 9 Financial Instruments. This means the amortised cost method cannot be used, and the fair value method must be used instead. This results in a fair value loss of €2 million, and a carrying value of €43 million. The interest received of €4 million is recognised as a gain in profit or loss. This results in a net gain of €2 million to profit or loss.

6. **Answer (b)**

The gain or loss on disposal is calculated as the difference between the sale proceeds (€45 million) and the carrying value of the subsidiary in the group financial statements immediately prior to disposal. This carrying value consists of opening net assets (€35 million) plus goodwill at carrying value (€12 million), plus total comprehensive income recognised up to the date of sale (€6 million * 6/12), total €50 million. Hence a loss of €5 million is recognised.

7. **Answer (a)**

There are two charges to profit. (1) interest charged on the lease. This is calculated as 10% * (€48.5m - €15m) = €3.35 million. (2) depreciation on the leased asset. Calculated on a straight line basis over the shorter of the lease term or the UEL of the asset. Here: €48.5m / 4 years = €12.125 million. Total charge €15.475 million.

8. **Answer (c)**

Under IAS 21 an asset purchased in foreign currency is translated into the functional currency of the entity at the date of purchase or revaluation and not restated otherwise. Hence there are two movements here:

Cost of property: US$40 million / 1.25	=	€32 million
Depreciation for year: €32 million / 20 years	=	€1.6 million (charged to profit or loss)
Carrying value at year end:		€30.4 million
Revalued amount: US$45 million / 1.125	=	€40 million
Revaluation gain: (40m – 30.4m)	=	€9.6 million (credited to OCI)

SOLUTION 4

Marking Scheme:

(a)	3 well developed points at 2 marks each		
	Subtotal		6
(b)	Calculation of relevant earnings:		
	(1)	Taking profit for the year (excluding OCI)	1
	(2)	Attributable to the parent (excluding non-controlling interest)	1
	(3)	Deducting preference dividend	1
	Calculation of weighted average number of shares in issue		
	(1)	Correct number of shares at beginning (allowing for €0.50 nominal value)	1
	(2)	Correct time weightings	1
	(3)	Inclusion of shares issued at full market value	1
	(4)	Calculation of TERP	1
	(5)	Calculation and correct application of rights issue bonus fraction	2
	(6)	Calculation and correct application of bonus issue bonus fraction	2
	(7)	Division of earnings by weighted average number of shares	1
	Calculation of the restated 2015 EPS		2
	Subtotal		**14**

[Total: 20 Marks]

SUGGESTED SOLUTION:

(a) Significance of the earnings per share figure

Earnings per share (EPS) is one of the most widely watched measures of company performance. As such it is the measure that is subject to most intense efforts to maximise its level and its growth. It is superior to other measures on many levels, but has some limitations also.

EPS gives a way to measure a company's profits relative to the number of shares in issue. It is argued that as owners hold equity shares, it is more relevant to them to know how much profit each share has earned than to know the overall profit figure.

EPS feeds into the price / earnings ratio, one of the most important stock market measures of value. This gives an estimate of the number of years it would take for an investment in an equity share to return itself in earnings terms, assuming current performance continues into the future.

It is essential that such an important measure of performance have clear guidelines regarding its calculation. IAS 33 Earnings per Share gives us a standardised method of calculating both earnings, and the number of shares.

Many investors feel that other measures are more appropriate, and that the IAS 33 definition of EPS is too conservative. IAS 33 allows alternative measures of EPS to be published, as long as the IAS 33 figure gets equal or greater prominence.

There is a danger in relying on a single measure of performance, as no single measure can encapsulate all aspects of an entity's performance.

Also, there is a danger that EPS may be seen by unsophisticated investors as a definite exact number, when in reality it is subject to all the accounting estimates and judgments that are necessary in preparing a set of financial statements.

Despite these fears, it is generally agreed that IAS 33 gives a very fair method of calculating EPS, and that the consistency it offers is of value to the investor and analyst. (6 marks)

(b) Earnings relevant to 2016 EPS calculation:

	€ million
Profit for the year (attributable to owners of the parent)	280
Less preference dividends (100 * 4%)	(4)
IAS 33 earnings	276

Number of equity shares in issue (weighted average) for year ended 31 July 2016:

Date	No. of Shares (m)	Time weight	TERP weighting	Bonus Issue weighting	W. Av no. of shares
1 Aug 2015	400	3/12	2 / 1.885	920/650	150.17
1 Nov 2015	+100 = 500	3/12	2 / 1.885	920/650	187.72
1 Feb 2016	+150 = 650	6/12		920/650	460.00
31 July 2016	+ 270 = 920	N/A			
31 July 2016	**Total**				**797.89**

1 Feb 2016: rights issue at discount – calculation of Theoretical Ex-Rights Price (TERP)

No. of shares in issue prior to rights issue (m)	500	€2.00	€1,000
No. of shares issued during rights issue	150	€1.50	€225
Total no. of shares after rights issue	650	€1.885	€1,225

All shares in issue prior to the rights issue are weighted by a bonus fraction equal to the ex-rights price (prior to the rights issue) divided by the TERP (2.00 / 1.885).

31 July 2016: Bonus issue – calculation of bonus fraction

No. of shares in issue prior to bonus issue	650
No. of shares in issue after bonus issue	920
Bonus fraction =	920 / 650

Weighted average number of shares in issue for year ended 31 July 2016 = 797.89 million

Basic EPS:	276 / 797.89
	€0.3459

Previous years' EPS figures need to be restated to reflect the distorting effect of issues of shares below market value. This is achieved by multiplying the previously calculated EPY by the inverse of the bonus fractions.

2015 EPS restated:	€0.525 * 1.885/2 * 650/920
	€0.3496

(14 marks)

[Total: 20 MARKS]

SOLUTION 5

Marking Scheme:

(a)	2 well developed points at 2 marks each Subtotal	 4
(b)	2 well developed points at 2 marks each Subtotal	 4
(c)	3 parts at 4 marks each Subtotal	 12

[Total: 20 Marks]

Suggested solution:

(a) It has been one of the failures of accounting regulation over the years that creative means of circumventing well-meaning rules have been found. The result of such efforts have been the undermining of faith in the ability of financial statements to reflect faithfully the truth and fairness of the performance and financial position of the reporting entity.

It has become clear that any hard rule can be creatively circumvented by contriving transactions appropriately. This is because transactions are necessarily structured between parties as they wish, and to suit their business needs. Regulators cannot anticipate the needs of transacting parties, and rules by their nature always lag behind the transactions themselves. In other words, as regulators see a transaction that is not covered by the existing rules, they seek to “plug the gap”. This is not a satisfactory way to ensure that financial statements reflect truth and fairness.

Since the 1990s, regulators have sought to implement a principles-based set of standards. These place the truth and fairness objective above any single rule. Indeed they require that rules be departed from if they do not result in a fair presentation of a transaction.

One of these key principles is “Substance over Form”. If a transaction is structured in such a way that the economic reality (substance) differs from the legal form of the transaction, the accounting must reflect the economic substance.

(4 marks)

(b) Features indicating that the substance of a transaction may differ from its legal form:

There are some key tell-tale indicators that should alert the accountant to the possibility that substance and form issues may exist. Some of these are:

- If two or more transactions are executed together, and the combined effect of both taken together is different from the effect of each individually, this is worth investigating. For example a sale transaction selling an asset (possibly at a price in excess of market) and an agreement to lease back that same asset (possibly at an inflated rental).
- Business arrangements entered into which seem to disproportionately advantage one party over another. There is nothing legally wrong with entering into an arrangement that is not in your best interests, but rational businesspeople tend not to do so unless there is a benefit elsewhere.
- Contrived option arrangements that serve to divert risk from where it might otherwise lie.
- Unusual terms in business agreements, that might affect our assessment of the timing of revenues and costs.
- Transactions may be structured to manipulate the reported results, for example by misreporting expenses as assets, or liabilities as revenue.

(6 marks)

(c)

(i) This transaction shows two characteristics suggesting the commercial substance may be different from its legal form. On the surface, there is a sale agreement showing the sale of a plot of land at a price higher than fair value. A shrewd decision one might conclude. However when one takes the two transactions together, we see that the benefit of this sale is not permanent. Rolojet has committed to buying back the land at an even higher price in 1 year's time.

This suggests that Rolojet has not transferred the risks and rewards of ownership of the land, as it will (under a binding agreement) reacquire them at a predetermined price. This is suggestive of a loan with interest, secured on the land. Why otherwise would the counterparty enter into the arrangement? What's in it for them except a fixed return of 10%? The other party has no opportunity to benefit or suffer from the economic value or risks embodied by the land.

Hence:
The land is not derecognised.
Cash received of €5 million is recognised on receipt, as is the obligation to repay this amount within 1 year.
As the year progresses, finance cost of €0.5 million is accrued on a time-weighted basis.

Journal:

1 August 2015	Dr Cash	€5.0 million	
	Cr Loan obligation		€5.0 million
During the year	Dr Profit or Loss	€0.5 million	
	Cr Loan obligation		€0.5 million

(4 marks)

(ii) This transaction shows a sale-or-return agreement. Under this agreement Rolojet cannot be said to have transferred the risks and rewards of the goods to its customer. The substance of the arrangement is that the goods are lent to the customer, who can return them at any time until sold on. Likewise, Rolojet has the right to require return. Hence risks and rewards are retained.

The goods should not be recorded as a sale, and no trade receivable recognised. Rather, they should be recorded as closing inventory, as cost price of €340,000.

Journal:

31 July 2016	Dr Inventory	€340,000	
	Cr Cost of Sales		€340,000

(4 marks)

(iii) This situation differs from the one in part (ii) because the risk taken on by the customer is greater. The customer has no right to return the goods (other than the normal legal right to return them if faulty). The only risk retained by Rolojet is credit risk. Credit risk does not prevent recognition of a sale under normal circumstances. Hence the goods should be recorded as a sale and a trade receivable recognised for the agreed price.

Journal:

10 July 2016	Dr Trade receivables	€250,000	
	Cr Revenue		€250,000

(4 marks)

[Total: 20 MARKS]