FINAL ADMITTING EXAMINATION (FAE)

ADVANCED APPLICATION OF FINANCIAL REPORTING PRINCIPLES (AAFRP)

INTERIM ASSESSMENT – DECEMBER 2018

FINAL EXAM VERSION

PAPER, EXAMINER'S REPORT AND SUGGESTED SOLUTION

Information Note:

This report contains the following documents:

Page 3	FAEC comments and summary of results;
Page 4	Exam paper (as sat on 8 December 2018);
Page 20	Suggested solution **with examiner's comments.**

As with all examinations, the solution is a 'suggested' solution only. Candidates who present alternative, valid solutions to any question will always receive the appropriate credit in an examination.

All references to the masculine gender within *this document are intended to refer to both male and female as appropriate*

SUMMARY OF RESULTS AND NOTE FROM THE FAEC

The December FAE AAFRP Interim Assessment 2018 sitting is the second sitting of the AAFRP where candidates receive a percentage based score that is carried forward to their FAE Core main examinations later this summer 2019.

The committee note this weaker set of results when compared to December 2017. Candidates have gained credit towards their August FAE Core examination albeit lower than their peers in 2018.

However there are two areas of concern where candidates struggled to get to grips with the questions. These are:

- Investment in associate;
- Cash-flows.

The FAE Committee would like to remind all candidates that all topics on the syllabus are examinable and the examiner is likely to revisit these areas of weakness again in the future, especially since the examiner specifically commented on cash flow in section 2 of the December 2017 report. Furthermore it should be noted that examiners at Core review candidate performance of AAFRP very closely.

SUMMARY OF RESULTS

1,210 candidates sat the AAFRP interim assessment in December 2018.

The AAFRP paper is worth 15% of a candidates overall grade at FAE. The result received by candidates is a percentage mark of up to 15%.

For example a candidate may receive a result of 9% for their AAFRP Interim assessment. This means the candidate is now carrying 9% towards their final grade at FAE.

If a candidate wishes to understand how they did at AAFRP, they simply divide this percentage by 0.15 and this converts their percentage score back to marks achieved in the AAFRP examination.

Example
Candidate receives a result of 9%, this converts to 9 divided by 0.15 = 60 marks. This means the candidate scored 60 marks out of 100 in their AAFRP examination.

Second Example
Candidate receives a score of 8.25%, this converts to 8.25 divided by 0.15 = 55 marks. This means the candidate scored 55 marks out of 100 in their AAFRP examination.

AAFRP December 2018 – Summary with 2017 comparable

	December 2018	December 2017
Number of candidates who sat AAFRP	1,210	1,142
Average marks achieved	58 marks out of 100	65 marks out of 100
Percentage of candidate achieving 50% or more	73%	83%

Desk Number: ____________________

Student Number: ____________________

Assessment Centre: ________________

Final Admitting Examination – Interim Assessment

Advanced Application of Financial Reporting Principles (AAFRP)

Saturday 8 December 2018 (11:00 am to 1:10 pm)

INSTRUCTIONS TO CANDIDATES

- Answers may only be written on the pages of this answer book.
- Students may not write on the answer book at any time before the Invigilator announces the official start of the assessment.
- You are required to remain seated at your desk until the Invigilator has collected this answer book from you.

DO NOT REMOVE THIS ANSWER BOOK FROM THE EXAMINATION HALL

- **This paper is divided into three sections.**
- **All questions in each section must be answered.**
- **In all questions, students should ignore any issues which might arise due to taxation implications (current or deferred) unless specifically directed otherwise.**

There are five questions in **Section 1**. Each question contains background information. You are required to consider this information, exercise judgement and decide what journal entry is required.

In **Section 1**, space is provided for workings/rough work. Students should carefully note the following:

1. Partial credit can be awarded for workings in **Section 1**.
2. Students are encouraged to include a note of their assumptions when responding to questions. As with any examination, assumptions are always considered and (if valid) appropriate credit given for the subsequent response.

There are three questions in **Section 2**. These are "cloze" type questions. Background information is supplied and a draft disclosure or other similar information will be drafted. You are required to assess whether the information provided is complete or whether other information is required. Guidance on the completion of these questions is given as part of the requirement each time. Partial credit can be awarded in **Section 2**, so you should ensure that you include any assumptions and workings in the spaces provided.

There are three questions in **Section 3**. Each question will contain background information and you are required to consider this information, exercise judgement and decide what journal entry is required. Questions in **Section 3** may be presented in such a way as to necessitate making key assumptions. Partial credit can also be awarded in **Section 3**, so you should ensure that you include any assumptions and workings in the spaces provided.

The following terminology will appear throughout the paper.

SPLOCI =	**Statement of Profit or Loss and Other Comprehensive Income**
SOFP =	**Statement of Financial Position**
P/L =	**Profit or Loss**
OCI =	**Other Comprehensive Income**

Journal entry is used to mean entry or entries

SECTION 1

(Overall suggested time – 45 minutes)

QUESTION 1.1: ALVA

Alva Ltd ("ALVA") has been operating in the telecommunications industry for many years. It has a growing reputation for successfully developing unique technologies and subsequently selling these to the highest bidder.

During 2017 €/£ 50,000 was spent researching potential uses for a new technology that was under development. The directors of ALVA were confident throughout 2017 that adequate resources were in place to complete the development and fully expect that this unique technology will generate significant economic benefit for ALVA. Indeed, on 31 December 2017, ALVA was offered €/£ 3,000,000 by an overseas company for the partially developed technology.

Separately, ALVA purchased a four-year licence for €/£ 800,000 cash on 1 January 2017. Legal fees of €/£ 20,000 were also paid in respect of the acquisition of this licence.

It is ALVA's policy to charge a full year's amortisation in the year of acquisition and no amortisation in the year of disposal. When possible, ALVA adopts the revaluation model in respect of its intangible assets. No entries have been made in the financial statements of ALVA in respect of the above.

Requirement:

Show the required journal entry to reflect the appropriate accounting treatment in the financial statements of ALVA for the year ended 31 December 2017.

Students should note that where both debit and credit entries are required for one account, only one entry should be made. This entry should be the net amount of the individual entries: i.e. if a journal required the bank to be debited by 100 and credited by 150, the correct net entry would be credit 50.

Answer Template

	Debit €/£	**Credit** €/£
Intangible assets - cost (SOFP)		
Intangible assets - accumulated amortisation (SOFP)		
Bank (SOFP)		
Operating expenses (SPLOCI)		
Amortisation expense (SPLOCI)		
Revaluation gain (SPLOCI)		

QUESTION 1.2: TARAGH

On 1 January 2016, Taragh Ltd ("TARAGH") purchased office accommodation at a cost of €/£ 100 million. The office accommodation is occupied by employees of TARAGH. It is being depreciated over 40 years on a straight-line basis with a nil residual value. TARAGH charges a full year's depreciation in the year of purchase.

During 2016 the local property market fell dramatically. The fair value of TARAGH's office accommodation declined to €/£ 80 million as at 31 December 2016. This asset was correctly recorded in the 31 December 2016 financial statements.

During 2017, as a consequence of a major employment announcement in the area, the local property market recovered significantly. The fair value of the office accommodation as at 31 December 2017 was professionally assessed at €/£ 110 million. TARAGH adopts the revaluation model when carrying its property, plant and equipment.

There has been no change to the original estimated life of the asset or its residual value. No entry has been made to the company financial statements for the year ended 31 December 2017.

Requirement:

Show the required journal entry to reflect the appropriate accounting treatment in the company financial statements of TARAGH for the year ended 31 December 2017.

Students should note that where both debit and credit entries are required for one account, only one entry should be made. This entry should be the net amount of the individual entries: i.e. if a journal required the bank to be debited by 100 and credited by 150, the correct net entry would be credit 50.

Answer Template

	Debit €/£	**Credit** €/£
Depreciation expense (SPLOCI)		
Impairment expense reversal (SPLOCI)		
Revaluation gain (OCI)		
Property, plant & equipment – net book value (SOFP)		

QUESTION 1.3: FINGLE

Fingle Plc ("FINGLE") operates in the automobile industry. Some years ago FINGLE acquired a 40% equity stake in one of its key suppliers, Saul Ltd ("SAUL"). FINGLE has since exercised significant influence over the financial and operating policy decisions of SAUL.

During the year ended 31 December 2017 SAUL sold goods to FINGLE totalling €/£ 12,000,000. SAUL made a mark-up of 25% on the sale. At 31 December 2017, FINGLE had half of these goods remaining in its inventory.

FINGLE is in the process of finalising its group financial statements for the year ended 31 December 2017. The only adjustment made to the group financial statements of FINGLE to date has been to debit revenue and credit cost of sales with €/£ 12,000,000.

Requirement:

Show the required journal entry to reflect the appropriate accounting treatment in the group financial statements of FINGLE for the year ended 31 December 2017.

Students should note that where both debit and credit entries are required for one account, only one entry should be made. This entry should be the net amount of the individual entries: i.e. if a journal required the bank to be debited by 100 and credited by 150, the correct net entry would be credit 50.

Answer Template

	Debit €/£	**Credit** €/£
Revenue (SPLOCI)		
Cost of sales (SPLOCI)		
Share of profit of associate (SPLOCI)		
Investment in associate (SOFP)		
Inventory (SOFP)		

QUESTION 1.4: DREAM

Dream Plc ("DREAM") is finalising its taxation journals for the year ended 31 December 2017 financial statements. The current tax charge for the financial year ended 31 December 2017 has been estimated at €/£ 420,000. The year ended 31 December 2016 current tax provision was under-estimated by €/£ 23,000.

The carrying value of DREAM's net assets exceeds their tax base by €/£ 90,000 as at 31 December 2017. DREAM has a deferred tax asset of €/£ 55,000 recorded in its financial statements at 1 January 2017. The applicable tax rate is 20%.

No entry to the financial statements of DREAM has been made in respect of the above.

Requirement:

Show the journal entry required to reflect the correct accounting treatment of the above tax information in the company financial statements of DREAM for the year ended 31 December 2017.

Students should note that where both debit and credit entries are required for one account, only one entry should be made. This entry should be the net amount of the individual entries: i.e. if a journal required the bank to be debited by 100 and credited by 150, the correct net entry would be credit 50.

Answer Template

	Debit €/£	**Credit** €/£
Income tax expense – current tax (SPLOCI)		
Income tax expense – deferred tax (SPLOCI)		
Current tax payable (SOFP)		
Deferred tax asset / liability (SOFP)		

QUESTION 1.5: AQIRE

Aqire Ltd ("AQIRE") purchased a power station on 1 January 2017 for €/£ 34,347,000. It was agreed that cash payment of the €/£ 34,347,000 would be made by AQIRE on 1 January 2018. AQIRE has a policy of depreciating power stations on a straight-line basis over their useful lives and charges a full year's depreciation in the year of acquisition. A nil residual value is expected.

The purchase contract requires AQIRE to dismantle the power station at the end of its 20-year life and make the site safe for alternative use. This is estimated to cost €/£ 25 million in 20 years. The present value of €/£ 25 million on 1 January 2017 is €/£ 6,460,500.

A discount rate of 7% should be assumed in any relevant calculations.

No entry to the financial statements of AQIRE has been made in respect of the above.

Requirement:

Show the journal entry required to reflect the correct accounting treatment of the above information in the company financial statements of AQIRE for the year ended 31 December 2017.

Students should note that where both debit and credit entries are required for one account, only one entry should be made. This entry should be the net amount of the individual entries: i.e. if a journal required the bank to be debited by 100 and credited by 150, the correct net entry would be credit 50.

Answer Template

	Debit €/£	**Credit** €/£
Property, plant & equipment – net book value (SOFP)		
Depreciation expense (SPLOCI)		
Power station payable (SOFP)		
Decommissioning provision (SOFP)		
Finance cost (SPLOCI)		

SECTION 2

(Overall suggested time – 40 minutes)

QUESTION 2.1: FITTER

Fitter Ltd ("FITTER") had the following opening equity balances as at 1 January 2017:

	€/£
Ordinary share capital (€/£ 1 shares)	620,000
Share premium	80,000
Retained earnings	1,200,000
Revaluation surplus	110,000

The financial accountant of FITTER has produced a draft set of financial statements which reveals a profit of €/£ 330,000 for the year ended 31 December 2017. The following items have not yet been accounted for:

(i) On 30 September 2017 FITTER issued 120,000 ordinary shares at €/£ 2.50 per share. All shares were fully paid up as of 30 November 2017;

(ii) A final equity dividend of 7 cents/pence per share was paid in December 2017;

(iii) With effect from 1 January 2017 FITTER adopted a revaluation policy for its specialised plant. The plant has a remaining useful life of four years. An independent valuation assessed its fair value at €/£ 1,100,000 at 1 January 2017. The plant had a carrying value of €/£ 600,000 prior to its revaluation on 1 January 2017. Depreciation of the plant has not yet been recorded in the year ended 31 December 2017 financial statements. FITTER elects to transfer excess depreciation from the revaluation reserve to retained earnings.

Requirement:

Using the information above, complete the following statement of changes in equity for the year ended 31 December 2017 for FITTER. Assume all appropriate accounting policies have been appropriately disclosed.

- ***You should input the required amounts in the given boxes (it is appropriate to leave the box blank if no input is required).***
- ***No disclosures are required.***

Statement of Changes in Equity

	Share capital €/£	**Share premium** €/£	**Retained earnings** €/£	**Revaluation surplus** €/£	**Total Equity** €/£
1 January 2017	620,000	80,000	1,200,000	110,000	2,010,000
Total comprehensive income for the year					
Share issue					
Ordinary dividend					
Transfer to retained earnings					
31 December 2017					

QUESTION 2.2: SPIRIT

Spirit Plc ("SPIRIT") is an established company within the pharmaceutical industry. It is currently preparing its financial statements for the year ended 31 December 2017.

On 14 January 2017, SPIRIT purchased a new factory for €/£ 3,600,000. SPIRIT adopts a policy of straight line depreciation and charges a full year's depreciation in the year of acquisition. The estimated useful life of the factory is 30 years.

The local authority paid a grant of €/£ 900,000 in respect of the factory to SPIRIT in March 2017. The grant was approved subject to SPIRIT employing 75 people for the first four years of the factory's operation. The factory has been operational since February 2017 and to date SPIRIT has employed in excess of 75 employees.

In June 2017 SPIRIT received an additional €/£ 50,000 grant from the local authority in respect of training courses for the factory's employees. The training courses commenced in March 2017 and were of six months' duration. This has been appropriately accounted for by SPIRIT in its 31 December 2017 financial statements.

Capital grants are recognised in the financial statements of SPIRIT using the deferred income method.

Deferred government grants in existence on 1 January 2017 should be amortised over ten years on a straight-line basis.

Requirement:

Using the information above, complete the following disclosure for the year ended 31 December 2017 for SPIRIT. Assume all accounting policies have been appropriately disclosed.

- ***You should first input the required amounts in the given boxes. (It is appropriate to leave the box blank if no input is required).***
- ***Then draft any additional disclosures required and indicate (by way of an asterisk) where the insert(s) might be included.***

Extract from notes to the financial statements:

Government Grants

	Total	Capital	Revenue
	€/£	€/£	€/£
At 1 January 2017	2,000,000	2,000,000	-
Received in year			
Amortised to profit or loss			
At 31 December 2017			

During the year the company received government grants of €/£ 900,000 in relation to the purchase of a factory.

The following amendment(s) is (are) required:
Please include an asterisk in the note above to indicate where the amendment should be included.

QUESTION 2.3: SANTO

Santo Plc ("SANTO") is in the process of preparing its group statement of cash flows for the year ended 31 December 2017. To date, the assistant financial controller has drafted a summary of some of the 2017 figures to be included.

	€/£ '000
Net cash generated from operating activities	3,100
Net cash generated from investing activities	(670)
Net cash generated from financing activities	1,320
Net increase / (decrease) in cash and cash equivalents	
Cash and cash equivalents as at 1 January 2017	4,050
Cash and cash equivalents as at 31 December 2017	

The following additional information is available. None of this information has been adjusted for in the above summary statement of cash flows.

1. The statement of financial position balances of SANTO as at 31 December include the following:

	2017 €/£ '000	**2016 €/£ '000**
Investment in associate	24,400	21,000
Inventory	3,500	600
Trade receivables	4,920	2,400
Trade payables	2,720	1,450
Non-controlling interest	1,150	700

2. On 1 January 2017 SANTO acquired 90% of Villa Ltd ('VILLA') paying €/£ 4 million in cash.

3. The non-controlling interest in VILLA had a fair value of €/£ 450,000 at the date of acquisition. The profit attributable to non-controlling interests for 2017 amounted €/£ 170,000.

4. VILLA's statement of financial position at 1 January 2017 included inventory of €/£ 3,000,000, trade receivables of €/£ 2,400,000 and trade payables of €/£ 900,000.

5. SANTO's share of profit of the associate for 2017 amounted to €/£ 4,800,000. This has been correctly included in the group profit or loss account for the year ended 31 December 2017.

Requirement:

Using the information above, complete the following summary group statement of cash flows for the year ended 31 December 2017 for SANTO. Assume all accounting policies have been appropriately disclosed.

- ***You should input the required amounts in the given boxes. (It is appropriate to leave the box blank if no input is required).***
- ***No disclosures are required.***

Draft group statement of cash flows for the year ended 31 December 2017

	€/£ '000
Net cash generated from / (used in) operating activities	
Net cash generated from / (used in) investing activities	
Net cash generated from / (used in) financing activities	
Net increase / (decrease) in cash and cash equivalents	
Cash and cash equivalents as at 1 January 2017	4,050
Cash and cash equivalents as at 31 December 2017	

SECTION 3

(Overall suggested time – 45 minutes)

QUESTION 3.1: REGISTER

Register Plc ("REGISTER") is an Irish based manufacturing and distribution company. The assistant financial controller is finalising the year ended 31 December 2017 financial statements. The following transactions took place during 2017:

1. REGISTER entered into a three-year operating lease agreement on 1 January 2017. The lease relates to an item of plant required in REGISTER's manufacturing process. REGISTER paid a non-refundable €/£ 2,000 up-front deposit on 1 January 2017. Under the terms of the lease an annual charge of €/£ 3,000 is payable by REGISTER to the lessor at the end of each year. At 31 December 2017 REGISTER had not yet made any payment in respect of the first year's annual charge;

2. On 1 January 2017 REGISTER entered into a four-year lease agreement for a machine. The machine has an expected useful life of four years. On 1 January 2017, the fair value of the asset was €/£ 40,400, which equalled the present value of the minimum lease payments using an effective interest rate of 6%. Under the terms of the lease, REGISTER is required to make annual lease payments of €/£ 11,000 on 1 January for each of the four years. The lessor has offered REGISTER the option to acquire the machine for €/£ 1 at the end of the lease term. It is expected that REGISTER will exercise this option;

3. On 1 January 2017, REGISTER purchased a warehouse for €/£ 600,000 which was paid for in cash. The warehouse has an expected useful life of 30 years with a nil residual value. The warehouse was immediately let to a third party at an annual rental income of €/£ 24,000. This first year's rent payment was received by REGISTER in January 2017. The fair value of the warehouse had increased to €/£ 645,000 at 31 December 2017. REGISTER applies the revaluation model when valuing its property, plant and equipment and adopts the fair value model for its investment properties.

No adjustment has been made to REGISTER's financial statements for the year ended 31 December 2017 in respect of the above transactions.

Requirement:

Show the journal entry required to reflect the correct accounting treatment for the above transactions in the financial statements of REGISTER for the year ended 31 December 2017. Use the space provided to display your workings and any reasoned assumptions you have made.

Students should note that where both debit and credit entries are required for one account, only one entry should be made. This entry should be the net amount of the individual entries: i.e. if a journal required the bank to be debited by 100 and credited by 150, the correct net entry would be credit 50.

	Debit €/£	**Credit €/£**
Lease expense (SPLOCI)		
Finance cost (SPLOCI)		
Depreciation expense (SPLOCI)		
Rental income (SPLOCI)		
Increase in fair value of warehouse (SPLOCI – P/L)		
Revaluation gain (SPLOCI – OCI)		
Bank (SOFP)		
Accrual (SOFP)		
Deferred asset (SOFP)		
Property, plant & equipment – net book value (SOFP)		
Finance lease liability (SOFP)		
Investment property (SOFP)		

QUESTION 3.2: ROCK

Rock Plc ("ROCK") is an Irish based manufacturer and distributor of high-end consumer products. The financial accountant is preparing the year ended 31 December 2017 financial statements. The items below need to be addressed.

1. At year end 31 December 2017, a physical inventory count conducted in the warehouse of ROCK revealed 500 raw material items which had been purchased at a cost of €/£ 8 per item.

300 units of finished goods were also in the warehouse. ROCK produced 4,000 units during the financial year ended 31 December 2017. Normal annual production is 5,000 units. The costs to produce these 4,000 units comprised €/£ 140,000 of materials, €/£ 180,000 of labour and €/£ 25,000 of variable overhead. Additionally, €/£ 40,000 of annual fixed production overhead was incurred during the year ended 31 December 2017.

ROCK has not yet accounted for closing inventory in its 31 December 2017 financial statements. There was no opening or closing work-in-progress on 31 December 2016 or 2017.

2. On 1 January 2017, ROCK purchased a plot of land for the purpose of constructing a new warehouse for ROCK's own use. Construction began immediately. The following related costs were incurred and paid by ROCK during the year ended 31 December 2017:

	€/£
Land – site for warehouse	200,000
Architect's costs	10,000
Solicitor fees	4,000
General administration costs	5,000
Direct materials	85,000
Direct labour	111,000
Production overhead	30,000

The warehouse was completed on 1 November 2017 and put into immediate use. As of this date the warehouse was deemed to have an estimated useful life of 20 years. ROCK applies a full year's depreciation in the year of purchase or construction. No entry has been made to ROCK's year ended 31 December 2017 financial statements in respect of the above items.

3. ROCK introduced an incentive scheme for its eight directors on 1 January 2016. Each director was granted 300,000 share appreciation rights on condition that the director remains in the employment of ROCK until 31 December 2019. All eight directors continued to be employed by ROCK at 31 December 2016 and, at that date, it was expected that seven directors would still be employed by ROCK on 31 December 2019. The nominal value of ROCK's ordinary shares is €/£ 1.50 per share.

One director left the company in November 2017. On 31 December 2017 it is estimated that five directors will remain employed by ROCK when the share appreciation rights vest on 31 December 2019.

The fair value of the share appreciation rights was €/£ 3.10 per share on 1 January 2016, €/£ 3.20 per share on 31 December 2016 and €/£ 3.40 per share on 31 December 2017. It is expected that the fair value will have increased to €/£ 3.80 per share on 31 December 2019.

ROCK has correctly accounted for the share appreciation rights in the 31 December 2016 financial statements. However, no entry has been made to the year ended 31 December 2017 financial statements.

Requirement:

Show the journal entry required to reflect the correct accounting treatment for the above transactions in the financial statements of ROCK for the year ended 31 December 2017. Use the space provided to display your workings and any reasoned assumptions you have made.

Students should note that where both debit and credit entries are required for one account, only one entry should be made. This entry should be the net amount of the individual entries: i.e. if a journal required the bank to be debited by 100 and credited by 150, the correct net entry would be credit 50.

	Debit €/£	**Credit €/£**
Inventory (SOFP)		
Closing inventory – cost of sales (SPLOCI)		
Expense – construction of warehouse (SPLOCI)		
Property, plant & equipment – net book value (SOFP)		
Bank (SOFP)		
Depreciation expense (SPLOCI)		
Share appreciation rights expense (SPLOCI)		
Share capital (SOFP)		
Share premium (SOFP)		
Equity – share based payment reserve (SOFP)		
Share based liability (SOFP)		

QUESTION 3.3: PORT

Port Ltd ("PORT") is an Irish based car dealership. The financial accountant is preparing the year ended 31 December 2017 financial statements. The following items remain outstanding:

1. On 1 December 2017, PORT purchased a building from an overseas entity for K$ 700,000. PORT has agreed to pay the K$ 700,000 on 1 February 2018. The building will be immediately occupied by employees of PORT and used for administrative purposes. PORT does not charge depreciation in the year of acquisition. Relevant exchange rates are:

Exchange rates	*K$: €/£*
1 December 2017	1.40 : 1
31 December 2017	1.30 : 1
1 February 2018	1.35 : 1

PORT has not yet accounted for the building in the year ended 31 December 2017 financial statements;

2. PORT operates a defined benefit (DB) pension scheme for its longer serving employees. PORT has correctly accounted for the pension scheme during 2017 and a net pension asset of €/£ 2,300,000 is recorded on the company statement of financial position. At 31 December 2017, the actuarial report has determined that the fair value of the pension plan asset should be revised downwards by €/£ 44,000, while the present value of the pension plan obligations should be revised downwards by €/£ 65,000. PORT has not yet accounted for this actuarial report information;

3. PORT operates a defined contribution (DC) pension scheme for its newer employees. PORT makes an annual contribution of 6% of gross salaries. In 2017 relevant gross salary costs amounted to €/£ 35 million. As at 31 December 2017 PORT has made contributions of €/£ 1,900,000 in respect of the 2017 financial year. No entry has been made in the year ended 31 December 2017 financial statements in respect of the defined contribution pension scheme;

4. PORT purchased 100 new identical commercial vehicles on 30 November 2017 for a total cost of €/£ 3,110,000. PORT intends to sell these vehicles in the ordinary course of its trade and the vehicles are currently recognised in closing inventory at their cost of €/£ 3,110,000. Due to economic factors outside the control of PORT, the expected sales price of these vehicles has reduced significantly.

Two markets, Europe and America, are accessible to PORT in respect of selling these vehicles. Details regarding the sale of the commercial vehicles in these markets are set out below:

	Vehicles sold to date by PORT in the Market	Total vehicles sold to date in the Market	Sales price per vehicle €/£
Europe	8,800	1,230,000	28,000
America	10,200	898,000	26,000

No entry has been made by PORT in respect of the fall in sales value of the commercial vehicles in the 31 December 2017 financial statements. You may ignore the impact of any associated selling costs.

Requirement:

Show the journal entry required to reflect the correct accounting treatment for the above transactions in the financial statements of PORT for the year ended 31 December 2017. Use the space provided to display your workings and any reasoned assumptions you have made.

Students should note that where both debit and credit entries are required for one account, only one entry should be made. This entry should be the net amount of the individual entries: i.e. if a journal required the bank to be debited by 100 and credited by 150, the correct net entry would be credit 50.

	Debit €/£	**Credit €/£**
Property, plant & equipment - cost (SOFP)		
Payable (SOFP)		
Foreign exchange gain / loss (SPLOCI - P/L)		
Pension asset (SOFP)		
DB pension remeasurement gain / loss (SPLOCI - OCI)		
DB pension remeasurement gain / loss (SPLOCI - P/L)		
DC pension expense (SPLOCI - P/L)		
DC pension expense (SPLOCI - OCI)		
Bank (SOFP)		
DC pension prepayment / accrual (SOFP)		
Closing inventory - cost of sales (SPLOCI)		
Inventory (SOFP)		

FAE AAFRP 8 DECEMBER 2018 SOLUTION

Examiner comment overall

Overall, this paper was well answered by the majority of candidates. The assessment covered a very broad range of international financial reporting standards. Candidates were required to demonstrate their understanding and application of these.

Overall, candidate performance in Section 1 was good. However knowledge gaps were evident around some of the accounting standards examined. Candidates are reminded that partial credit is available and it is important to provide clear workings in support of their final journal entry.

On the whole Section 2 was poorly answered. The statement of cash flow and government grant disclosures proved to be particularly weak areas for many candidates.

Section 3 of the exam required practical application of a wide range of accounting standards. This section was generally quite well answered. Accounting for defined benefit and defined contribution pension schemes proved troublesome for many candidates however.

Examiner comment – Section 1

Candidates generally performed well in Section 1, however some exceptions were notable. A knowledge gap was evident amongst candidates when accounting for associates in accordance with IAS 28 *Accounting for associates and joint ventures* (Q1.3). It was also disappointing to note how the recognition and subsequent unwinding of the decommissioning provision proved an area of extreme weakness for candidates (Q1.5). These areas will be revisited in forthcoming AAFRP assessments.

It was pleasing to note the improved candidate performance in calculating deferred tax in accordance with IAS 12 *Income* Taxes. This had been identified as an area if weakness in the December 2017 examiner report.

Method marks are available and as such it is important for candidates to provide clear, labelled workings and not to rely solely on making the correct journal entry.

Solution 1.1: ALVA

	Debit €/£	**Credit** €/£
Intangible assets - cost (SOFP)	820,000	
Intangible assets – accumulated amortisation (SOFP)		205,000
Bank (SOFP)		870,000
Operating expense (SPLOCI)	50,000	
Amortisation expense (SPLOCI)	205,000	
Revaluation gain (SPLOCI)		

The €/£ 50,000 spent researching may not be capitalized, and should be written off to profit or loss. The €/£ 3 million offer may not be recognised unless it is accepted. Revaluation of intangibles is only permitted by reference to an active market in identical assets. This asset is unique, hence whilst it may be valuable; it cannot be verified by reference to an active market.
The licence should be recognised at its cost amount of €/£ 820,000. This is inclusive of the legal fees incurred in bringing the asset to its current condition. Amortisation should begin when the asset is available for use (*IAS 38.97).* Hence, amortisation of €/£ 205,000 should be charged for 2017 (€/£ 820k / 4 years).

Question 1.2: TARAGH

	Debit €/£	**Credit** €/£
Depreciation expense (SPLOCI)	2,051,282	
Impairment expense reversal (SPLOCI)		17,500,000
Revaluation gain (OCI)		14,551,282
Property, plant & equipment – net book value (SOFP) (32,051 – 2,051)	30,000,000	

At 31 December 2016, prior to the recognition of the impairment loss, the asset has a net book value of €/£ 97.5 million, being €/£ 100 million less depreciation of €/£ 2.5 million (€/£ 100 / 40 years). Upon the fall in value to €/£ 80 million, an impairment loss of €/£ 17.5 million arises (€/£ 97.5 - €/£ 80). In the year ended 31 December 2016, this loss is recognised as an expense in profit or loss *(IAS 16.40).*
For the year ended 31 December 2017 the asset continues to be depreciated over its remaining useful life of 39 years, meaning a depreciation expense of €/£ 2.051 million (€/£ 80 million / 39 years) should be recorded in P/L for that year. The asset then has a carrying value of €/£ 77.949 million (€/£ 80 - €/£ 2.051).
At 31 December 2017 the asset is revalued to €/£ 110 million, an increase of €/£ 32.051 million (€/£ 110 - €/£ 77.949). €/£ 17.5 million, being the reversal of the impairment loss charged in 2016, is credited to profit or loss. The balance of €/£ 14.551 million is credited to other comprehensive income *(IAS 16.39).*

Alternative Solution

	Debit €/£	Credit €/£
Depreciation expense (SPLOCI)	2,051,282	
Impairment expense reversal (SPLOCI)		17,051,282
Revaluation gain (OCI)		15,000,000
Property, plant & equipment – net book value (SOFP) (32,051 – 2,051)	30,000,000	

The increased carrying amount due to reversal should not be more than what the depreciated historical cost would have been if the impairment had not been recognised *(IAS 36.117)*.
€/£ 17.051 million is credited to profit or loss. This comprises a reversal of the €/£ 17.5 million impairment loss charged in 2016, less €/£ 0·449 million for the depreciation that would have been charged if the asset had not been devalued (€/£ 17.5 million / 39 years). The balance of €/£ 15 million is credited to other comprehensive income *(IAS 16.39; IAS 36.119).*

Question 1.3: FINGLE

	Debit €/£	**Credit** €/£
Revenue (SPLOCI)		12,000,000
Cost of sales (SPLOCI)	12,000,000	
Share of profit of associate (SPLOCI)	480,000	
Investment in associate (SOFP)		
Inventory (SOFP)		480,000

Note

Saul Ltd is an associate of Fingle plc. No cancellation of intragroup transactions should take place between the investor and the associate. However IAS 28 stipulates that the investor's share (40%) of unrealised profits between the investor and the associate should be eliminated *(IAS 28.22)*.
Given a 25% mark-up, the profit arising on sales of €/£ 12 million amounts to €/£ 2.4 million of which one half, or €/£ 1.2 million, is unrealised by the group. Fingle plc's share of this profit totals €/£ 480k (€/£ 1.2 million * 40%).
As seller of the goods, Saul Ltd's share of profit is reduced by €/£ 480k in the group profit or loss account. As the holder of the goods, the value of Fingle's closing inventory is reduced by €/£ 480k.

Alternative Solution

	Debit €/£	**Credit** €/£
Revenue (SPLOCI)		12,000,000
Cost of sales (SPLOCI)	12,480,000	
Share of profit of associate (SPLOCI)		
Investment in associate (SOFP)		
Inventory (SOFP)		480,000

Solution 1.4: DREAM

	Debit €/£	**Credit** €/£
Income tax expense – current tax (SPLOCI)	443,000	
Income tax expense – deferred tax (SPLOCI)	73,000	
Current tax payable (SOFP)		443,000
Deferred tax asset / liability (SOFP)		73,000

Workings

	Debit €/£	**Credit** €/£
Dr Income tax expense – current tax (SPLOCI)	420,000	
Cr Current tax payable (SOFP)		420,000
Being current year tax payable estimation		
Dr Income tax expense – current tax (SPLOCI)	23,000	
Cr Current tax payable (SOFP)		23,000
Being adjustment for prior year under-provision		
Dr Income tax expense – deferred tax (SPLOCI)	73,000	
Cr Deferred tax asset / liability (SOFP) (55,000 + 18,000)		73,000
*Being elimination of DT asset and recording of DT liability (€/£ 90,000*20%)*		

QUESTION 1.5: AQIRE

	Debit €/£	**Credit** €/£
Property, plant & equipment – net book value (SOFP) (€/£ 32,100,000 + €/£ 6,460,500 - €/£ 1,928,025)	36,632,475	
Depreciation expense (SPLOCI)	1,928,025	
Power station payable (SOFP) (€/£ 32,100,000 + €/£ 2,247,000)		34,347,000
Decommissioning provision (SOFP) (€/£ 6,460,500 + €/£ 452,235)		6,912,735
Finance cost (SPLOCI) (€/£ 2,247,000 + €/£ 452,235)	2,699,235	

An item of property, plant and equipment should initially be recorded at cost *[IAS 16.15]*. Cost includes all costs necessary to bring the asset to working condition for its intended use. This would include not only its original purchase price but also costs of site preparation, delivery and handling, installation, related professional fees for architects and engineers, and the estimated cost of dismantling and removing the asset and restoring the site *[IAS 16.16-17].* (See *IAS 37* Provisions, Contingent Liabilities and Contingent Assets.)

If payment for an item of property, plant, and equipment is deferred, interest at a market rate must be recognised [IAS 16.23].

The power station is measured at its present value of €/£ 32,100,000 at 1 January 2017 (€/£ 34,347 / 1.07). Over the course of 2017 the liability is increased by the 7% interest rate (€/£ 32,100 * 7% = €/£ 2,247). The corresponding journal entries are:

	Debit €/£	**Credit** €/£
Property, plant & equipment – net book value (SOFP)	32,100,000	
Power station payable (SOFP)		32,100,000
Being recognition of the power station asset and liability at present value		
Power station payable (SOFP)		2,247,000
Finance cost (SPLOCI)	2,247,000	
Being recognition of the finance cost of 7%		

The cost of the asset should also include the estimated cost of removing the asset and restoring the site. The present value of this obligation is €/£ 6,460,500 at 1 January 2017. The provision should be increased by unwinding the discount over 2017 (€/£ 6,460,500 * 7% = €/£ 452,235); the increase should be recognised as a finance cost in the profit or loss account.

	Debit €/£	**Credit** €/£
Property, plant & equipment – net book value (SOFP)	6,460,500	
Decommissioning provision (SOFP)		6,460,500
Being recognition of the decommissioning cost of the power station		
Decommissioning provision (SOFP)		452,235
Finance cost (SPLOCI)	452,235	
Being unwinding of the discount in 2017		

The asset cost should be depreciated over its useful economic life of 20 years ({€/£ 32,100k + €/£ 6,460.5k} / 20 = €/£ 1,928,025.

Examiner comment – Section 2

Overall candidate performance in this section was poor. It was disappointing to note that the consolidated statement of cash flow (Q2.3) continues to cause significant difficulty for students, especially having been highlighted as an area of weakness in the December 2017 examination. The importance of labelled support workings is particularly important in this question.

The quantitative element of the government grant note extract was reasonably well answered. However, the qualitative disclosures were often missed and generally incomplete.

The suggested solution which follows illustrates one possible answer to each question. As disclosures can be provided in different forms, while still complying with international financial reporting standards and legislation, other solutions are acceptable and candidates were rewarded accordingly.

SOLUTION 2.1: FITTER

Extract from Notes to the Financial Statements

	Share capital €/£	Share premium €/£	Retained earnings €/£	Revaluation surplus €/£	Total equity €/£
1 January 2017	620,000	80,000	1,200,000	110,000	2,010,000
Total comprehensive income for the year			55,000	500,000	555,000
Share issue	120,000	180,000			300,000
Ordinary dividend			(51,800)		(51,800)
Transfer to retained earnings			125,000	(125,000)	-
31 December 2017	740,000	260,000	1,328,200	485,000	2,813,200

Tutorial Note

(i) FITTER issues an additional 120,000 shares to shareholders. €/£ 2.50 is received for each share meaning total funds of €/£ 300,000 are raised. The share capital account records the nominal value of each share (120,000 * €/£ 1 = €/£ 120,000) while the balance is recorded in the share premium account (120,000 * €/£ 1.50 = €/£ 180,000).

(ii) The December dividend payment was made when FITTER had 740,000 shares in issue (620,000 + 120,000). Hence, this dividend payment totals €/£ 51,800 (740,000 shares * 7 cents/pence per share). The dividend is deducted from retained earnings.

(iii) FITTER recognises a revaluation gain of €/£ 500,000 (€/£ 1,100k - €/£ 600k) in other comprehensive income which is accumulated in the revaluation surplus on 1 January 2017. The depreciation charge to be recognised in profit or loss is €/£ 275,000 (€/£ 1,100k / 4 years), meaning a revised profit of €/£ 55,000 (€/£ 330k - €/£ 275k). The excess depreciation to be transferred from revaluation surplus to retained earnings is €/£ 125,000 (€/£ 275k – €/£ 150k {600/4}).

SOLUTION 2.2: SPIRIT

Extract from notes to the financial statements:

Government Grants

	Total	Capital	Revenue
	€/£	€/£	€/£
At 1 January 2017	2,000,000	2,000,000	0
Received in year	950,000	900,000	50,000
Amortised to profit or loss	(280,000)	(230,000)	(50,000)
At 31 December 2017	2,670,000	2,670,000	0

During the year the company received government grants of €/£ 900,000 in relation to the purchase of a factory. * **

The following amendment(s) is (are) required:

Please include an asterisk in the note above to indicate where the amendment should be included.

* Contingent Liabilities

The company received a grant of €/£ 900,000 for a new factory building. This is being amortised over the useful life of the building. In order to comply with the conditions of the grant, the company must continue to employ 75 employees for a further three years so as to ensure the grant is not repayable.

** Revenue Grant

The company received a €/£ 50,000 grant towards training courses for the employees of the new factory. This has been recognised in the statement of profit or loss.

Tutorial Note

Government grants, including non-monetary grants at fair value, shall not be recognised until there is reasonable assurance that:

a) the entity will comply with the conditions attaching to them; and

b) the grants will be received *(IAS 20.7).*

SPIRIT received a grant of €/£ 900,000 during the year. The condition relating to the employment of 75 people is satisfied as at 31 December 2017. However, this grant will be repayable by SPIRIT should this condition not be met for a four year period. Hence, in addition to recognising the grant, SPIRIT should disclose a contingent liability in respect of the possible repayment.

The grant is amortised in the same proportion in which depreciation on the related asset is charged *(IAS 20.17)*. As the factory is depreciated over 30 years on a straight line basis with a full year's depreciation charged in the year of purchase, then similarly, €/£ 30,000 should be released from deferred grant income and recognised as grant income in the profit or loss (€/£ 900,000 / 30 years = €/£ 30,000). The remaining €/£ 270,000 of the grant should be recognised as a liability in the year-ended 31 December 2017 financial statements.

The €/£ 50,000 grant received in respect of the employee training costs is recognised in the same period as the related expense. Hence, it is recognised in SPIRIT's 31 December year-end profit or loss account either separately as other income or deducted from the related expense *(IAS 20.29)*. The nature and extent of government grants recognised in the financial statements should be disclosed *(IAS 20.39{b})*.

The opening deferred grant income of €/£ 2,000,000 is amortised on a straight-line basis over ten years meaning an additional €/£ 200,000 amortisation charge is recognised during the period.

SOLUTION 2.3: SANTO

Draft statement of cash flows for the year ended 31 December 2017

	€/£ '000
Net cash generated from / (used in) operating activities	(1,350)
Net cash generated from / (used in) investing activities	(3,270)
Net cash generated from / (used in) financing activities	1,150
Net increase / (decrease) in cash and cash equivalents	(3,470)
Cash and cash equivalents as at 1 January 2017	4,050
Cash and cash equivalents as at 31 December 2017	580

Workings

		€/£ '000
Operating:	(3,100 – 4,800 + 100 – 120 + 370)	(1,350)
Investing:	(-670 – 4,000 + 1,400)	(3,270)
Financing:	(1,320 - 170)	1,150

Tutorial Note

Note 1

The payment of €/£ 4 million is a cash flow and should be included under investing activities.

Note 2: Dividend received from associate

Opening Balance	21,000
Share of profit of associate	4,800
	25,800
Dividend received (balance)	(1,400)
Closing balance	24,400

Dividend received from the associate may be included as a cash flow under operating activities or investing activities. Share of profit of associate is deducted under operating activities.

Note 3: Dividends paid to non-controlling interests

Opening balance	700
Acquisition of subsidiary	450
Profit attributable to NCI	170
	1,320
Dividend paid (balance)	(170)
Closing balance	1,150

The dividend paid to the NCI is included as a cash flow under either operating, investing or financing activities.

Note 4: Working capital cash flows

	2017	**2016**	**Op. Profit Adjustment**
Inventory (3,500 – 3,000)	500	600	100
Trade receivables (4,920 – 2,400)	2,520	2,400	(120)
Trade payables (2,720 - 900)	1,820	1,450	370

Changes in working capital are included in the statement of cash flows under operating activities.

Examiner comment – Section 3

It was pleasing to note that the majority of scripts contained detailed, labelled workings for each separate element of each question.

Question 3.1: This question was well answered. It was pleasing to note the strong candidate performance with respect to accounting for the operating and finance leases, especially as lease accounting had been identified as areas of weakness in prior examiner reports.

Question 3.2: This question was reasonably well answered. Candidates were required to demonstrate an understanding of inventory valuation in accordance with IAS 2 *Inventories,* cost recognition and subsequent depreciation of a new warehouse as per IAS 16 *Property, plant & equipment* and accounting for share based payments as per IFRS 2 *Share-based payment.*

Generally students performed well in valuing the inventory and accounting for the warehouse. A significant minority of candidates struggled with the measurement of the share based payment however.

Question 3.3: This question tested candidates' understanding of fair value measurement, foreign currency translation and accounting for pension schemes. Generally, candidate performance was mixed. Many students struggled in correctly accounting for the movements in the defined contribution and defined benefit pension schemes. Accounting for pension schemes will be revisited in forthcoming AAFRP assessments.

SOLUTION 3.1: REGISTER

	Debit €/£	**Credit** €/£
Lease expense (SPLOCI)	3,667	
Finance cost (SPLOCI)	1,764	
Depreciation expense (SPLOCI)	10,100	
Rental income (SPLOCI)		24,000
Increase in fair value of warehouse (SPLOCI – P/L)		45,000
Revaluation gain (SPLOCI – OCI)		
Bank (SOFP) (2,000 + 11,000 + 600,000 - 24,000)		589,000
Accrual (SOFP)		1,667
Deferred asset (SOFP)		
Property, plant & equipment – net book value (SOFP) (40,400 – 10,100)	30,300	
Finance lease liability (SOFP) (40,400 – 11,000 + 1,764)		31,164
Investment property (SOFP) (600,000 + 45,000)	645,000	

Workings

1. **Operating Lease**

	Debit €/£	**Credit** €/£
Lease expense (SPLOCI – P/L)	3,667	
Bank (SOFP)		2,000
Accrual (SOFP)		1,667
Deferred asset (SOFP)		

Lease payments under an operating lease should be recognised as an expense on a straight-line basis over the lease term unless another systematic basis is more representative of the time pattern of the user's benefit *(IAS 17.33)*. Hence, total lease payments of €/£ 11,000 (being the €/£ 2,000 deposit plus the €/£ 3,000 payable each year for 3 years) divided by the lease term of 3 years, generates an annual lease expense of €/£ 3,667.
At year-end REGISTER has paid €/£ 2,000 meaning an amount of €/£ 1,667 should be accrued at year-end 31 December 2017.

2. Finance Lease

	Debit €/£	Credit €/£
Dr Property, plant & equipment (SOFP)	40,400	
Cr Finance lease liability (SOFP)		40,400
Being recognition of property and finance lease liability		
Dr Depreciation expense (SPLOCI)	10,100	
Cr Property, plant & equipment - accumulated depreciation (SOFP)		10,100
Being recognition of depreciation expense		
Dr Finance lease liability (SOFP)	11,000	
Cr Bank (SOFP)		11,000
Being recognition of lease payment in advance		
Dr Finance cost (SPLOCI)	1,764	
Cr Finance lease liability (SOFP)		1,764
Being recognition of 6% finance cost		

Note

The life of the lease (4 years) is equal to the life of the asset (4 years). The fair value of the asset is equal to the present value of the minimum lease payments (€/£ 40,400). It is expected that REGISTER will exercise its option to acquire the asset for €/£ 1 at the end of the current lease term. Hence, there are indicators of transfer of the risk and rewards of the asset to the lessee (REGISTER) and the lease should be accounted for as a finance lease.

At inception of the lease the asset should be capitalised at €/£ 40,400 and a corresponding lease liability recorded *(IAS 17.20)*. A depreciation charge of €/£ 10,100 (€/£ 40,400 / 4 years) is recorded for the year ended 31 December 2017.

Under the actuarial method the finance lease liability should be measured at amortised cost. The lease liability of €/£ 40,400 recognised at inception is reduced by the €/£ 11,000 payment in advance. The effective interest annual cost of €/£ 1,764 is applied to the balance (€/£ 29,400 * 6%) meaning a closing liability of €/£ 31,164.

3. Investment Property

	Debit €/£	Credit €/£
Investment property (SOFP)	600,000	
Bank (SOFP)		600,000
Investment property (SOFP)	45,000	
Increase in fair value of warehouse (SPLOCI – P/L)		45,000
Bank (SOFP)	24,000	
Rental income (SPLOCI)		24,000

IAS 40 *Investment Property* applies to land and/or buildings held to earn rentals or for capital appreciation (or both). Hence, REGISTER's warehouse qualifies as an investment property.

An investment property measured at fair value will record any gain or loss arising from a change in fair value in the profit or loss account (*IAS 40.35).* Hence, the €/£ 45,000 increase in fair value (€/£ 645,000 – €/£ 600,000) is recognised in P/L. The rent received of €/£ 24,000 is recorded as income in profit or loss.

SOLUTION 3.2: ROCK

	Debit €/£	**Credit €/£**
Inventory (SOFP)	32,275	
Closing inventory – cost of sales (SPLOCI)		32,275
Expense – construction of warehouse (SPLOCI)	5,000	
Property, plant & equipment – net book value (SOFP) (440,000 – 12,000)	428,000	
Bank (SOFP)		445,000
Depreciation expense (SPLOCI)	12,000	
Share appreciation rights expense (SPLOCI)	870,000	
Share capital (SOFP)		
Share premium (SOFP)		
Equity – share based payment reserve (SOFP)		
Share based liability (SOFP)		870,000

Workings

1. **Inventory**

	Debit €/£	**Credit** €/£
Inventory (SOFP)	32,275	
Closing inventory – cost of sales (SPLOCI – P/L)		32,275

Raw material (500 * 8)	4,000
Finished goods (300 * 94.25 **W1**)	28,275
	32,275

Working 1

Material	140,000
Labour	180,000
Variable overhead	25,000
	345,000
Per unit (345k / 4,000)	86.25
Fixed overhead p.u (40,000 / 5,000 units)	8.00
Total cost per unit of finished good	94.25

2. New Warehouse

	Debit €/£	**Credit** €/£
PPE – net book value (SOFP)	440,000	
General administration costs (SPLOCI)	5,000	
Bank		445,000
Depreciation expense (SPLOCI)	12,000	
PPE – net book value		12,000

<u>Note</u>
The new warehouse should originally be measured at cost. This comprises the purchase price plus the cost of bringing the asset to the condition necessary for use *(IAS 16.16)*. This excludes general administration costs of €/£ 5,000 which should be expensed, but includes the remaining items which total €/£ 440,000.

In calculating the annul depreciation, the land cost of €/£ 200,000 is deemed to be the residual value of the warehouse. Hence, annual depreciation amounts to €/£ 12,000 [(440 – 200) / 20 years].

3. Share Based Payment

	Debit €/£	**Credit** €/£
Share appreciation right expense (SPLOCI)	870,000	
Share based liability (SOFP)		870,000
Being increase in fair value of share based liability		

<u>Note</u>
The share appreciation rights represent a cash settled share based payment. A liability and a corresponding expense should be recognised in the financial statements of ROCK. The fair value of the liability should be re-measured at each reporting date, and should consider the number of directors expected to be in the scheme at the vesting date of 31 December 2019.

At 31 December 2017, the fair value of the liability measured at €/£ 2,550,000, representing an increase of €/£ 870,000 from 31 December 2016.

	€/£
Liability at 31 December 2016	
(300,000 * 3.20 * (8 - 1) / 4 years * 1 year	1,680,000
Liability at 31 December 2017	
(300,000 * 3.40 * (8 – 1 - 2) / 4 years * 2 years	2,550,000

SOLUTION 3.3: PORT

	Debit €/£	Credit €/£
Property, plant & equipment – cost (SOFP)	500,000	
Payable (SOFP) (500,000 + 38,462)		538,462
Foreign exchange gain / loss (SPLOCI – P/L)	38,462	
Pension asset (SOFP) (65,000 – 44,000)	21,000	
DB pension remeasurement gain / loss (SPLOCI - OCI)		21,000
DB pension remeasurement gain / loss (SPLOCI – P/L)		
DC pension expense (SPLOCI – P/L)	2,100,000	
DC pension expense (SPLOCI – OCI)		
Bank (SOFP)		1,900,000
DC pension prepayment / accrual (SOFP)		200,000
Closing inventory – cost of sales (SPLOCI)	310,000	
Inventory (SOFP)		310,000

1. Foreign Building

	Debit €/£	Credit €/£
Property, plant & equipment – cost (SOFP)	500,000	
Payable (SOFP)		500,000
Being recognition of PPE at 1/12/2017		
Foreign exchange loss (SPLOCI – P/L)	38,462	
Payable (SOFP)		38,462
Being loss on retranslation of payable at 31/12/2017		

Note

A foreign currency transaction should be recorded in the entity's functional currency on initial recognition using the spot rate at the date of the transaction *(IAS 21.21)*. Hence, the purchase of the building is recorded using the 1 December 2017 spot rate (K$ 700,000 dollars / 1.40 = €/£ 500,000).
At the reporting date of 31 December 2017, the outstanding payable should be retranslated as of that date (K$ 700,000 dollars / 1.30 = €/£ 538,462). Any exchange gain or loss on retranslation (€/£ 500,000 - €/£ 538,462 = €/£ 38,462 loss) should be taken to the statement of profit or loss in that accounting period *(IAS 21.28).* As a non-monetary asset the factory should not be retranslated *(IAS 21.23).*

2. Defined Benefit Pension Scheme

	Debit €/£	Credit €/£
Pension asset (SOFP)	21,000	
Re-measurement gain (OCI) (65 – 44)		21,000
Being actuarial re-measurement of net pension asset at 31/12/2017		

3. Defined Contribution Pension Scheme

	Debit €/£	**Credit** €/£
Pension expense (SPLOCI – P/L) (35m * 6%)	2,100,000	
Bank (SOFP)		1,900,000
Accrual (SOFP)		200,000
Being recording of defined contribution at 31/12/2017		

4. Inventory (IAS 2 and IFRS 13)

Inventory is measured at the lower of its cost and net realisable value. Net realisable value is the fair value of the asset less the cost to sell *(IAS 2.9)*.
When measuring the fair value of the asset, it is assumed that the transaction takes place in the principal market for that asset *(IFRS 13.24)*. The principal market is the market with the overall highest volume and level of activity (IFRS 13 Appendix A). The principal market is not determined based on the volume of PORT's transactions in that market. Hence, in the case of the commercial vehicles, Europe is deemed to be the principal market.
As such, the fair value of the 100 commercial vehicles totals €/£ 2,800,000 (100 vehicles * €/£ 28,000). Inventory in PORT should be written down by €/£ 310,000 at 31 December 2017, being the difference between the recognised cost and the lower fair value (€/£ 3,110k - €/£ 2,800k). There are no vehicles selling costs provided in the question.

	Debit €/£	**Credit** €/£
Closing inventory – cost of sales (SPLOCI)	310,000	
Inventory (SOFP)		310,000
Being decrease in closing inventory valuation		