FINAL ADMITTING EXAMINATION (FAE)

ADVANCED APPLICATION OF FINANCIAL REPORTING PRINCIPLES (AAFRP)

INTERIM ASSESSMENT – DECEMBER 2017

FINAL EXAM VERSION

PAPER, EXAMINER'S REPORT AND SUGGESTED SOLUTION

Information Note:

This report contains the following documents:

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 2017 sitting is the first sitting of the AAFRP where candidates will no longer receive a grade for their results, but instead receive a percentage based score that is carried forward to their FAE Core main examinations later this summer 2018.

The committee are pleased to note these are the second highest set of AAFRP results since AAFRP was introduced in 2010. Many candidates have scored well and have gained credit towards their August FAE Core examination.

The FAE Committee also notes the improvement in answers to Section 1. Changes were made to the marking of section 1 where method marks can be awarded for candidates' efforts. This appears to have helped candidates in this sitting.

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

- Leases;
- Statement of 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 leases in the January 2017 report.

SUMMARY OF RESULTS
1,165 candidates sat the AAFRP interim assessment in December 2017. 1,142 candidates who are registered to sit the Core diet in August 2018 will receive results under the numerical based marking methodology. A candidate's score is weighted as part of their overall grade in FAE.

23 Candidates repeated their AAFRP as part of the 16-17 autumn re-sits. These candidates were assessed on the previous five point scale, from Not Addressed (NA) to Highly Competent (HC), depending on their overall performance. As Competent and Highly Competent are treated the same in the overall adjudication these two points are combined.

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 2017 – Summary (Excluding re-sit candidates)

Number of candidates who sat AAFRP	1,142
Average marks achieved	65 marks out of 100
Percentage of candidate achieving 50% or more	83%

No comarable data exists for January 2017

Desk Number: ______________________

StudentNumber: ___________________

Assessment Centre: ________________

Final Admitting Examination – Interim Assessment

Advanced Application of Financial Reporting Principles (AAFRP)

Saturday 9 December 2017 (11.00 am to 1:10 pm)

INSTRUCTIONS TO CANDIDATES

- Answers may only be written on the pages of this answer book.
- Student 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, if any, is required.

The possible numerical solutions will be given in a table, titled "Figures for journal entry (if required) €/£" and you must choose which numbers are correct and then use these to complete the template provided. If you believe that no journal entry is required, then the "no journal entry required" box should be ticked.

In **Section 1**, space is provided for workings/rough work. However, 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**, each examining a different disclosure. This is a "cloze" type question. Background information is supplied and a draft disclosure or other similar information will be drafted. You are required to assess whether the draft disclosure 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, if any, 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
SOCI = Statement of 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: LAURENCE

Laurence Plc (“LAURENCE”) purchased a new industrial machine on 1 July 2016 for €/£ 100,000 cash. The machine is to be depreciated on a straight line basis over eight years and no residual value is expected.

The new machine replaces an existing machine with a carrying value of €/£ 7,000 at 1 July 2016. This machine had been acquired at a cost of €/£ 75,000 some years ago, has not been subject to revaluation since its purchase and has now been written-off as obsolete. No scrap value was received by LAURENCE in relation to the disposal.

No entries have been made in the financial statements of LAURENCE for the year ended 30 June 2017 in relation to the above.

Requirement:

Show the journal entry required, if any, to reflect the above information in the financial statements of LAURENCE for the year ended 30 June 2017. (If you consider a journal entry is required, use the figures given to complete the answer template). Use the space provided to display your workings.

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.

Figures for journal entry (if required) €/£

100,000	**86,000**	**75,000**	**68,000**	**55,500**
45,500	**32,000**	**25,000**	**12,500**	**7,000**

Answer Template:

	Debit €/£	**Credit** €/£
Property plant and equipment – cost (SOFP)		
Property, plant and equipment – accumulated depreciation (SOFP)		
Bank (SOFP)		
Depreciation expense (SPLOCI)		
Profit / loss on disposal (SPLOCI)		

No journal entry required ☐

QUESTION 1.2: BARRON

Barron Plc ("BARRON") entered into a four-year operating lease on 1 July 2016. As an incentive to enter the lease, BARRON received a €/£ 3,000 non-refundable cash incentive from the lessor in early July 2016. Under the terms of the lease an annual charge of €/£ 5,000 is payable by BARRON at the end of each year. During May 2017 BARRON paid the €/£ 5,000 charge in respect of the first year. The leased asset is a machine with a useful life of ten years.

No entries have been made in the accounts of BARRON in respect of the above.

Requirement:

Show the required journal entry, if any, necessary to reflect the correct accounting treatment in BARRON for the year ended 30 June 2017. (If you consider a journal entry is required, use the figures given to complete the answer template). Use the space provided to display your workings.

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: ie: if a journal required the bank to be debited by 100 and credited by 150, the correct net entry would be credit 50.

Figures for journal entry (if required) €/£

23,000	**20,000**	**17,000**	**5,750**	**5,000**
4,250	**3,000**	**2,250**	**2,000**	**1,250**

Answer Template

	Debit €/£	**Credit** €/£
Property, plant & equipment (SOFP)		
Property, plant & equipment depreciation expense (SPLOCI)		
Bank (SOFP)		
Lease expense (SPLOCI)		
Prepayment (SOFP)		
Deferred income (SOFP)		

No journal entry required ☐

QUESTION 1.3: SHIRE

On 1 October 2013 Shire Plc ("SHIRE") purchased an item of plant for €/£ 300,000. At that date, the item had a useful life of eight years and a residual value of €/£ 40,000. On 1 October 2016 the plant was reviewed for impairment and found to have a net realisable value of €/£ 135,000 and a value in use of €/£ 160,000. The asset's total useful life and residual value were unchanged.

No entries have been made in the financial statements of SHIRE for the year ended 30 September 2017 in relation to the above.

Requirement:

Show the required journal entry, if any, to reflect the above events in the financial statements of SHIRE for the year ended 30 September 2017. (If you consider a journal entry is required, use the figures provided to complete the answer template). Use the space provided to display your workings.

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.

Figures for journal entry (if required) €/£

300,000	**160,000**	**140,000**	**112,500**	**73,500**
66,500	**42,500**	**25,000**	**24,000**	**19,000**

Answer Template:

	Debit €/£	**Credit** €/£
Property plant and equipment – cost (SOFP)		
Property, plant and equipment – accumulated depreciation (SOFP)		
Depreciation expense (SPLOCI)		
Impairment expense (SPLOCI)		

No journal entry required ☐

QUESTION 1.4: MATHEW

Mathew Plc ("MATHEW") granted 100 share options to each of its 200 employees on 1 January 2016. Each grant is conditional upon the employee working for the entity for the next three years. The fair value of each share option as at 1 January 2016 is €/£ 17. This increased to €/£ 19 at 31 December 2016.

Seven employees left MATHEW during 2016 and it is anticipated that a further 15 employees will leave the company before the end of 2018.

MATHEW's share price at 31 December 2016 is €/£ 21.50.

Requirement:

Show the journal entry required, if any, to reflect the above information in the financial statements of MATHEW for the year ended 31 December 2016. (If you consider a journal entry is required, use the figures given to complete the answer template). Use the space provided to display your workings.

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.

Figures for journal entry (if required) €/£

397,750	**382,700**	**338,200**	**314,500**	**302,600**
132,583	**127,567**	**112,733**	**104,833**	**100,867**

Answer Template:

	Debit €/£	**Credit** €/£
Bank (SOFP)		
Share option expense (SPLOCI)		
Equity – share option reserve (SOFP)		
Accrual (SOFP)		

No journal entry required ☐

QUESTION 1.5: TINAS

Tinas Ltd (TINAS) purchased an item of plant on 1 January 2015 paying €/£ 20 million. The plant is used in TINAS' ordinary course of business and is being depreciated over ten years on a straight-line basis with a nil residual value.

The plant was revalued to €/£ 25 million on 31 December 2015. The asset was correctly accounted for by TINAS in its financial statements for the year ended 31 December 2015.

One year later, on 31 December 2016, it was revalued to €/£ 12 million. There has been no change to the 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 2016. TINAS does not adopt the policy of transferring excess depreciation from the revaluation reserve to retained earnings.

Requirement:

Show the journal entry required, if any, to reflect the above information in the financial statements of TINAS for the year ended 31 December 2016. (If you consider a journal entry is required, use the figures given to complete the answer template). Use the space provided to display your workings.

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.

Figures for journal entry (if required) €/£ '000

13,000	**12,000**	**10,500**	**10,222**	**7,000**
5,000	**3,500**	**3,222**	**2,778**	**2,500**

Answer Template:

	Debit €/£ '000	**Credit** €/£ '000
Property, plant & equipment – net book value (SOFP)		
Depreciation expense (SPLOCI)		
Revaluation gain (OCI)		
Impairment expense (SPLOCI)		

No journal entry required ☐

SECTION 2

(Overall suggested time – 45 minutes)

QUESTION 2.1: LONDAN

Londan Plc ("LONDAN"), a construction company, is currently preparing its financial statements for the year ended 30 June 2017.

During the financial year to 30 June 2017 a detailed restructuring plan was drawn up for LONDAN. Terms of the plan have already been communicated to LONDAN's employees and their union representatives. Additionally, details of the restructuring plan are in the public domain.

Some employees will face compulsory redundancy as a consequence of the planned restructuring. The expected redundancy cost to LONDAN is €/£ 400,000. It is expected that 12 additional employees will be redeployed within the company and €/£ 36,000 of re-training costs will be incurred as a consequence. LONDAN will also invest €/£ 60,000 in new computer systems to support the restructuring. Implementation of the restructuring was due to commence in October 2017 and be completed within a six month period. At 30 June 2017 LONDAN remains on course to meet this expected completion date. None of the costs have been recognised to date in the financial statements of LONDAN as at 30 June 2017.

The opening provision of €/£ 250,000 is in respect of an onerous contract which LONDAN entered in to some years earlier. On 30 June 2017 this provision was revised downwards to €/£ 190,000.

On 24 November 2017, one of the construction sites of LONDAN suffered serious damage following a fire. Management are hopeful that the greater part of the damage will be covered by insurance. They do however expect to incur significant costs owing to the associated clean-up. Surveyors are still assessing the financial impact of the damage and are currently unable to provide reliable estimates of the eventual cost.

Requirement:

Using the information above, complete the following disclosure for the year ended 30 June 2017 for LONDAN. Assume all accounting policies have been appropriately disclosed.

- ***You should first complete the required amounts in the given boxes. (It is appropriate to leave the box blank if no input is required).***
- ***Please then either:***
  - ***Select the option "No further amendment(s) required;" OR***
  - ***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:

Provisions

	Onerous Contract	Restructuring provision	Total provisions
	€/£	€/£	€/£
At 1 July 2016	250,000	0	250,000
Utilised in the year			
Income statement charge/(release)			
At 30 June 2017			

No further amendment(s) required ☐

<u>OR</u>

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

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

QUESTION 2.2: RATAG

Ratag Plc ("RATAG") is a growing company within the automobile industry. It is currently preparing its financial statements for the year ended 31 December 2016.

During the year ended 31 December 2016, RATAG received a government grant to help finance the purchase of plant and machinery. The plant and machinery grant is for up to a maximum of €/£ 450,000 based on a company spend of up to €/£ 750,000. RATAG had received the full amount of the grant by 31 December 2016.

The grant was approved subject to RATAG purchasing the relevant plant and machinery and hiring an additional 20 employees. At 31 December 2016 RATAG has hired in excess of 20 additional employees and has purchased €/£ 600,000 of the relevant plant and machinery. It is the intention of the directors to purchase a further €/£ 300,000 of plant and machinery during the year ended 31 December 2017, assuming appropriate finance can be secured.

Capital grants are recognised in the financial statements of RATAG using the deferred income method. It is the company's policy to depreciate plant and machinery over ten years on a straight-line basis. A full year's depreciation is charged in the year of acquisition, irrespective of the date of purchase.

Deferred government grants in existence on 1 January 2016 should be amortised over five years on a straight-line basis.

Requirement:

Using the information above, complete the following disclosure for the year ended 31 December 2016 for RATAG. Assume all accounting policies have been appropriately disclosed.

- ***You should first complete the required amounts in the given boxes. (It is appropriate to leave the box blank if no input is required).***
- ***Please then either:***
  - ***Select the option "No further amendment(s) required;" OR***
  - ***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

	€/£
At 1 January 2016	100,000
Recognised in the year	
Amortised to profit or loss in year	
At 31 December 2016	

During the year the company received government grants of €/£ 450,000 in relation to the purchase of plant and machinery.

No further amendment(s) required ☐

<u>OR</u>

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: SINNE

Sinne Group ("SINNE") is in the process of preparing its financial statements for the year ended 31 December 2016. The financial controller has drafted a summary of the 2016 figures to be included in the group statement of cash flows.

	€/£ '000
Net cash generated from operating activities	7,300
Net cash generated from investing activities	1,800
Net cash generated from financing activities	500
Net increase / (decrease) in cash and cash equivalents	
Cash and cash equivalents as at 1 January 2016	10,200
Cash and cash equivalents as at 31 December 2016	

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

1. Property, plant and equipment

	Cost **€/£ '000**	**Accumulated Depreciation** **€/£ '000**	**Net Book Value** **€/£ '000**
At 1 January 2016	43,600	(19,500)	24,100
New finance lease additions	4,300	-	4,300
Purchase of new machinery	2,100	-	2,100
Disposal of property	(5,000)	2,800	(2,200)
Depreciation for the year		(2,500)	
At 31 December 2016	45,000	(19,200)	25,800

2. Total finance lease obligations, exclusive of any finance costs accrued, amounted to €/£ 8,800,000 on 1 January 2016 and €/£ 10,300,000 on 31 December 2016.

3. The disposed property was sold by SINNE for €/£ 2,700,000. The acquisition of new machinery of €/£ 2,100,000 was a cash purchase.

4. Dividends received during the financial year totalled €/£ 450,000.

5. The non-controlling interest of SINNE totalled €/£ 5,000,000 on 1 January 2016 and €/£ 5,550,000 on 31 December 2016. The profit attributable to non-controlling interests for 2016 amounted €/£ 700,000.

Requirement:

Using the information above, complete the following disclosure for the year ended 31 December 2016 for SINNE. Assume all accounting policies have been appropriately disclosed.

- ***You should first complete the required amounts in the given boxes. (It is appropriate to leave the box blank if no input is required).***
- ***Please then either:***
  - ***Select the option "No further amendment(s) required;" OR***
  - ***Draft any additional disclosures required and indicate (by way of an asterisk) where the insert(s) might be included.***

Draft statement of cash flows for the year ended 31 December 2016

	€/£ '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 2016	10,200
Cash and cash equivalents as at 31 December 2016	

No further amendment(s) required ☐

OR

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

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

SECTION 3

(Overall suggested time – 40 minutes)

QUESTION 3.1: CROSS

Cross Plc ("CROSS") operates a defined benefit pension plan for its employees. At 1 January 2016 the fair value of the pension plan assets was €/£ 7,000,000 and the present value of the pension plan obligations was €/£ 7,300,000.

The actuary estimated that the service cost for the year to 31 December 2016 was €/£ 1,200,000. The pension plan paid €/£ 400,000 to retired members and CROSS paid €/£ 1,700,000 in contributions to the pension plan on 31 December 2016. The actuary estimated that the relevant discount rate for the year to 31 December 2016 was 6%.

On 31 December 2016 CROSS announced improvements to the benefits offered by the pension plan to all of its members. The actuary estimated that the past service cost associated with these improvements was €/£ 1,000,000.

At 31 December 2016 the fair value of the pension plan assets was €/£ 9,000,000 and the present value of the pension plan obligations (including the past service costs) was €/£ 11,300,000.

The following journal has been recorded by CROSS in respect of the pension scheme:

	Debit €/£ '000	**Credit** €/£ '000
Dr Pension plan asset	1,700	
Cr Bank		1,700

No other entries have been made in the financial statements relating to the defined benefit pension plan since the previous year end.

Requirement:

Show the journal entry required, if any, to reflect the correct accounting treatment of the above information in the company financial statements of CROSS for the year ended 31 December 2016. Use the space provided to display your workings.

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 €/£ '000	**Credit** €/£ '000
Net pension liability (SOFP)		
Defined benefit pension expense (SPLOCI – P/L)		
Defined benefit pension remeasurement (SPLOCI – OCI)		
Bank (SOFP)		

No journal entry required ☐

QUESTION 3.2: JAKE

Jake Plc ("JAKE") is an Irish services company. The financial statements for the year ended 31 December 2016 are currently being prepared. The financial controller wishes to reflect the deferred tax impact of the following transactions:

1. JAKE made an onerous contract provision of €/£ 100,000 in the 31 December 2016 year end accounts. It is expected that this provision will be utilised in the next two years. In the tax jurisdiction in which JAKE operates, this provision is only deductible on a paid basis;

2. On 30 June 2016, JAKE received €/£ 400,000 from a customer. This payment was in respect of services to be provided by JAKE in 2016 and 2017. JAKE correctly recognised revenue of €/£ 240,000 in respect of this transaction in the year ended 31 December 2016 and will recognise the remainder in the year ended 31 December 2017. Under the tax jurisdiction in which JAKE operates, the €/£ 400,000 is taxed when received and was correctly included in the calculation of the current tax expense of JAKE for the year ended 31 December 2016;

3. On 1 January 2016, JAKE purchased a plot of land for €/£ 3,000,000. The land is measured using the revaluation model. On 31 December 2016, the land was revalued to its fair value of €/£ 3,400,000 in JAKE's financial statements. In the tax jurisdiction in which JAKE operates, unrealised gains and losses arising on the revaluation of land are not taxable unless the asset is sold. JAKE has not sold the land at year end. The land is not subject to depreciation.

The applicable rate of tax is 25%. JAKE is a profitable company which consistently generates annual taxable profits of at least €/£ 2,000,000. There should be no offsetting of deferred tax assets and deferred tax liabilities.

No entry has been made by JAKE to reflect the deferred tax impact in respect of the above for the year-ended 31 December 2016.

Requirement:

Show the journal entry required, if any, to reflect the correct accounting treatment for the above transaction in the financial statements of JAKE for the year ended 31 December 2016. 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** €/£
Deferred tax asset (SOFP)		
Deferred tax liability (SOFP)		
Tax expense (SPLOCI – P/L)		
Tax expense (SPLOCI – OCI)		

No journal entry required ☐

QUESTION 3.3 KOLO

Kolo Plc ("KOLO") operates in the information technology wholesale sector and has prepared its draft financial statements for the year ending 31 December 2016. The assistant accountant has highlighted the following transactions with which she would like some assistance:

1. On 1 February 2016 KOLO sold goods on credit to Lorn Ltd ("LORN"). The goods had a list price of €/£ 300,000. However, given its positive trading history with LORN, KOLO allowed a trade discount of 20%. Additionally, the terms of the sale allowed an early settlement discount of €/£ 15,000 provided payment was made before 28 February 2016. On 26 February 2016, LORN paid €/£ 225,000 in final settlement of the amount payable. No entry has been made by KOLO to reflect the accounting treatment in respect of any of the above;

2. Due to unforeseen operational reasons the inventory of KOLO was not counted until 4 January 2017. On 3 January 2017 KOLO made a sale totalling €/£ 780,000 on which a mark-up of 20% was recorded. The sold goods were not included as part of the inventory count on 4 January 2017. In the 31 December 2016 financial statements, KOLO's assistant accountant has credited revenue and debited trade receivables with the full sale amount;

3. On 1 March 2016, following a company re-organisation, KOLO raised finance by way of a fully subscribed rights issue of one new share for every ten in issue at €/£ 9 per share. KOLO had €/£ 1,500,000 of issued equity share capital at 1 January 2016. Each share has a par value of €/£ 0.25. There were no other issues of equity shares during the year. No entry has been made by KOLO to reflect the accounting treatment in respect of the share issue for the year-ended 31 December 2016;

4. KOLO paid an ordinary dividend of four cents/pence per share on 31 January 2016 and six cents/pence per share on 30 September 2016. Neither dividend payment has been accounted for.

Requirement:

Show the journal entry required to correctly reflect the above events in the financial statements of KOLO for the year ended 31 December 2016. 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** €/£
Revenue (SPLOCI)		
Trade receivables (SOFP)		
Closing inventory (SOFP)		
Cost of sales (SPLOCI)		
Discount allowed (SPLOCI)		
Administration expense (SPLOCI)		
Bank (SOFP)		
Share capital (SOFP)		
Share premium (SOFP)		
Retained earnings (SOFP)		

No journal entry required ☐

FAE DECEMBER 2017 AAFRP – SUGGESTED SOLUTION

Examiner comment overall

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

Overall, candidate performance in Section 1 was good. Knowledge gaps were evident around some of the accounting standards examined in this section. Candidates are reminded to provide clear workings in support of their final journal entry.

On the whole Section 2 was reasonably well answered. However, the statement of cash flow proved particularly troublesome for a significant number of candidates.

Section 3 of the exam required practical application of a wide range of accounting standards. This section was reasonably well answered. A significant minority of candidates struggled with the calculation of the deferred tax asset/liability.

SECTION 1

Examiner comment – Section 1

Candidates generally performed well in Section 1. It was disappointing to note however that the accounting treatment for operating leases continues to cause significant difficulty for students, especially having been highlighted as an area of weakness in the December 2016 diet. Allocation of impairment loss of an asset between other comprehensive income and profit or loss also proved troublesome for candidates.

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.

Question 1.1: LAURENCE

	Debit €/£	**Credit** €/£
Property plant and equipment – cost (SOFP)	25,000	
Property, plant and equipment – accumulated depreciation (SOFP)	55,500	
Bank (SOFP)		100,000
Depreciation expense (SPLOCI)	12,500	
Profit / loss on disposal (SPLOCI)	7,000	

New Machine

	Debit €/£	**Credit** €/£
Property, plant and equipment – cost (SOFP)	100,000	
Bank (SOFP)		100,000
Being purchase of new machine for cash		
Depreciation expense (SPLOCI)	12,500	
Property, plant and equipment – accumulated depreciation (SOFP)		12,500
Being charge for annual depreciation		

Old Machine

	Debit €/£	**Credit** €/£
Property, plant and equipment – accumulated depreciation (SOFP)	68,000	
Property, plant and equipment – cost (SOFP)		75,000
Loss on disposal (SPLOCI)	7,000	
Being disposal of old machine		

Question 1.2: BARRON

	Debit €/£	**Credit** €/£
Property plant & equipment (SOFP)		
Property, plant & equipment depreciation expense (SPLOCI)		
Bank (SOFP)		2,000
Lease expense (SPLOCI)	4,250	
Prepayment (SOFP)		
Deferred income (SOFP)		2,250

Note

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 €/£ 17,000 (being the €/£ 5,000 payable each year for four years less the €/£ 3,000 incentive) divided by the lease term of four years, generates an annual lease expense of €/£ 4,250.

At the year-end BARRON has paid a net amount €/£ 2,000 in respect of the lease (being the €/£ 5,000 payment less the €/£ 3,000 receipt), meaning deferred income of €/£ 2,250 (€/£ 4,250 - €/£ 2,000) should be recorded as a current liability on the SOFP.

The leased asset should not be capitalised on the SOFP of the lessee (BARRON) nor should any asset depreciation be recorded.

Question 1.3: SHIRE

	Debit €/£	**Credit** €/£
Property plant and equipment – cost (SOFP)		
Property, plant and equipment – accumulated depreciation (SOFP)		66,500
Depreciation expense (SPLOCI)	24,000	
Impairment expense (SPLOCI)	42,500	

Workings

	Debit €/£	**Credit** €/£
Property, plant and equipment – cost (SOFP)		
Property, plant and equipment – accumulated depreciation (SOFP)		42,500
Impairment expense (SPLOCI)	42,500	
Being impairment of plant on 1 October 2016		
Depreciation expense (SPLOCI)	24,000	
Property, plant and equipment – accumulated depreciation (SOFP)		24,000
Being charge for annual depreciation		

<u>Note</u>

The carrying amount of the asset at 1 October 2016 is €/£ 202,500, being cost of €/£ 300,000 less three years depreciation charge totalling €/£ 97,500 (3 years * {€/£ 300,000 - €/£ 40,000} / 8 years).

An asset should not be carried at more than its recoverable amount. The recoverable amount of the item of plant is €/£ 160,000, being the higher of that asset's value in use (€/£ 160,000) and its net realisable value (€/£ 135,000) *(IAS 36.6).*

Hence, at 1 October 2016, the asset is impaired by €/£ 42,500 (€/£ 202,500 – €/£ 160,000). The asset should be written down in value to its recoverable amount of €/£ 160,000 and an impairment expense should be recorded in the profit or loss account.

Depreciation for that year is based on the remaining asset value (€/£ 160,000) and the asset's remaining useful life (5 years). The asset's residual value remains unchanged at €/£ 40,000, thus a depreciation expense of €/£ 24,000 for the year ended 30 September 2017 should be recorded ({€/£ 160,000 - €/£ 40,000} / 5 years).

Question 1.4: MATHEW

This is an equity-settled share-based payment transaction as per IFRS 2. The share options are measured at fair value at the grant date, being €/£ 17 at 1 January 2016. The expense recognised at the end of 2016 is based on the number of employees expected to be still employed by MATHEW at the end of 2018 (200 – 7 – 15 = 178) and is recognised over the three year vesting period.

The subsequent fair value of the share options and the year-end share price has no effect on the share-based payment expense recognised at year end.

Hence; 100 share options * 178 employees * €/£ 17 * 1/3 = €/£ 100,867.

Answer Template:

	Debit €/£	**Credit** €/£
Bank (SOFP)		
Share option expense (SPLOCI)	100,867	
Equity – share option reserve (SOFP)		100,867
Accrual (SOFP)		

No journal entry required ☐

Question 1.5: TINAS

	Debit €/£ '000	**Credit** €/£ '000
Property, plant & equipment – net book value (SOFP) (2.78 + 10.22)		13,000
Depreciation expense (SPLOCI)	2,778	
Revaluation gain (OCI)	7,000	
Impairment expense (SPLOCI)	3,222	

At 31 December 2015, prior to the revaluation, the asset has a net book value of €/£ 18 million, being €/£ 20 million less depreciation of €/£ 2 million. A revaluation gain of €/£ 7 million arises (€/£ 25 - €/£ 18); this gain is recognised in other comprehensive income and accumulated in equity under the heading of revaluation surplus *(IAS 16.39).*

For the year ended 31 December 2016 the asset continues to be depreciated over its remaining useful life of nine years, meaning a depreciation expense of €/£ 2.778 million (€/£ 25 million / 9 years) should be recorded in the P/L for that year. Prior to revaluation the asset has a carrying value of €/£ 22.222 million (€/£ 25- €/£ 2.778). Upon revaluation to €/£ 12 million the asset has fallen in value by €/£ 10.222 million.

As the asset has previously been revalued upwards by €/£ 7 million, the decrease in value should first be debited to other comprehensive income (€/£ 7 million revaluation loss) and the balance of €/£ 3.222 million recognised in the P/L *(IAS 16.40).*

SECTION 2

Examiner comment – Section 2

Candidate performance in this section was mixed overall. Some candidates continue to have difficult in distinguishing between an accounting policy and an accounting disclosure.

In particular, candidates struggled with the statement of cash flow (Q2.3). Support workings were generally very poor and the vast majority of candidates struggled to identify the dividend paid to the non-controlling interest. The poor quality of response is surprising considering the statement of cash flow forms a significant part of students' CAP 2 Financial Reporting studies.

In Section 2 the tables and empty boxes provided were to assist candidates in producing the relevant disclosures. 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: LONDAN

Extract from notes to the financial statements:

Provisions

	Onerous Contract	Restructuring provision	Total provisions
	€/£	€/£	€/£
At 1 July 2016	250,000	0	250,000
Utilised in the year	0	0	0
Income statement charge/(release)	(60,000)	400,000	340,000
At 30 June 2017	190,000	400,000	590,000

*

**

No further amendment(s) required ☐

<u>OR</u>

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

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

* Provisions

During the year LONDAN announced details of a planned restructuring. As a consequence of the restructuring compulsory redundancies will take place. The provision of €/£ 400,000 represents management's best estimate of these redundancy costs. Additionally, redeployment of staff and investment in new computer systems is expected to take place. It is expected that the restructuring will be completed by the end of 2017.

A provision exists at year end in relation to an onerous contract. The provision of €/£ 190,000 represents management's best estimate of the expected cost in relation to this contract.

** Event After the Reporting Period

On 24 November 2017, one of the construction sites of LONDAN suffered serious damage following a fire. Management are hopeful that the greater part of the damage will be covered by insurance. They do however expect to incur significant costs owing to the associated clean-up. Surveyors are still assessing the financial impact of the damage and are currently unable to provide reliable estimates of the eventual cost.

Tutorial Note

Restructuring Provision

A provision for restructuring costs is recognised only when the entity has a constructive obligation to restructure. Such an obligation only arises where an entity:

- Has a detailed formal plan for the restructuring, and
- Has raised a valid expectation in those affected that it will carry out the restructuring by starting to implement the plan or announcing its main features to those affected by it.

In this case a detailed plan has been formulated to reorganise the company. This plan has already been communicated to the employees concerned and their union representatives, and details of the plan are publicly known.

Hence, the restructuring of LONDAN appears to satisfy the conditions of restructuring provisions under IAS 37. The re-training and computer investment costs however are prohibited from inclusion within the restructuring provision *(IAS 37.81)* as these relate to the future conduct of the business. The redundancy provision of €/£ 400,000 should be recognised in LONDAN's financial statements for the year ended 31 December 2016.

For each class of provision an entity shall disclose the carrying amount at the beginning and end of the period, additional provisions made and amounts used or reversed during the period *(IAS 37.84)*. An entity shall disclose a brief description of the nature of the obligation and the expected timing of any resulting outflows of economic benefits *(IAS 37.85).*

Event after the Reporting Period

A fire after the reporting period is a non-adjusting event in accordance with IAS 10 *(IAS 10.22{d})*. For each material category of non-adjusting event the entity should disclose:

- The nature of the event; and
- An estimate of its financial effect, or a statement that such an estimate cannot be made

SOLUTION 2.2: RATAG

Extract from notes to the financial statements:

Government Grants

	€/£
At 1 January 2016	100,000
Recognised in the year	360,000
Amortised to profit or loss in year	(56,000)
At 31 December 2016	404,000

*

During the year the company received government grants of €/£ 450,000 in relation to the purchase of plant and machinery. **

No further amendment(s) required ☐

OR

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

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

* Contingent Liability

RATAG received a grant of €/£ 450,000 for the purchase of plant and machinery. In order to comply with the conditions of the grant, RATAG must spend €/£ 750,000 on additional plant and machinery and hire an additional 20 employees. At 31 December 2016, RATAG has hired in excess of 20 additional employees and has purchased €/£ 600,000 of plant and machinery. €/£ 150,000 of additional plant and machinery must be purchased in order to ensure the grant is not repayable.

** Capital grants are recognised in the financial statements of RATAG using the deferred income method. At the year-end 31 December 2016, the conditions in relation to €/£ 360,000 of this grant have been fulfilled and this has been recognised in the financial statements. The remaining €/£ 90,000 will be recognised when additional plant and machinery is purchased.

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)

Ratag Plc received a grant of €/£ 450,000 during the year. The two conditions relating to the grant are the hire of additional employees and the purchase of plant and machinery. Sufficient additional employees have been hired; however of the total grant of €/£ 450,000, only €/£ 360,000 (€/£ 450,000 * €/£ 600,000 / €/£ 750,000) has been satisfied in relation to the purchase of plant and machinery. Furthermore, Ratag Plc's full compliance with the grant conditions is subject to securing appropriate finance which is not yet certain.

Hence, €/£ 360,000 is recognised as deferred grant income in the financial statements of Ratag Plc. The grant is amortised in the same proportion in which depreciation on the related asset is charged (IAS 20.17). As the plant and machinery is depreciated over ten years on a straight line basis with a full year's depreciation charged in the year of purchase, then similarly, €/£ 36,000 should be released from deferred grant income and recognised as grant income in the profit or loss of Ratag Plc (€/£ 360,000 / 10 years = €/£ 36,000).

The remaining €/£ 90,000 of the grant should be recognised in the year-ended 31 December 2017, assuming Ratag Plc purchases the related plant and machinery.

The deferred grant income of €/£ 100,000 is amortised on a straight-line basis over five years meaning an additional €/£ 20,000 amortisation charge is recognised during the period.

SOLUTION 2.3: SINNE

Draft statement of cash flows for the year ended 31 December 2016

	€/£ '000
Net cash generated from / (used in) operating activities	9,300
Net cash generated from / (used in) investing activities	2,850
Net cash generated from / (used in) financing activities	(2,450)
Net increase / (decrease) in cash and cash equivalents	9,700
Cash and cash equivalents as at 1 January 2016	10,200
Cash and cash equivalents as at 31 December 2016	19,900

No further amendment(s) required ☐

Workings

		€/£ '000
Operating:	(7,300 + 2,500 - 500)	9,300
Investing:	(1,800 - 2,100 + 2,700 + 450)	2,850
Financing:	(500 - 2,800 - 150)	(2,450)

Tutorial Note

Note 1

The purchase of new machinery represents an outflow of cash (€/£ 2,100,000) under investing activities. Depreciation for the year of €/£ 2,500,000 is not a cash flow item and is added back under operating activities.

Note 2

The cash flow impact in respect of finance leases represents repayment of a principal amount of €/£ 2,800,000 being; opening finance lease obligation plus new finance lease entered into during 2016, less closing finance lease obligation (€/£ 8,800,000 + €/£ 4,300,000 - €/£ 10,300,000 = €/£ 2,800,000).

Note 3

Cash received from sale of the property is a cash flow receipt under investing activities. The profit on the sale of the property of €/£ 500,000 (€/£ 2,700,000 - €/£ 2,200,000) is not a cash item and is deducted under operating activities.

Note 4

The dividend received of €/£ 450,000 is a cash inflow under operating, investing or financing activities (IAS 7.31). In the above solution it is shown as an investing cash flow.

Note 5

A dividend of €/£ 150,000 has been paid to non-controlling interests during 2016 (€/£ 5,000k + €/£ 700k - €/£ 5,550k). This is a cash outflow and can be included on the statement of cash flows under either operating, investing or financing activities. In the suggested solution (above), it appears under financing activities.

SECTION 3

Examiner comment – Section 3

Question 3.1: This question was well answered. The candidate was required to reconcile the opening and closing balances of a defined benefit pension plan asset and a pension plan obligation. A significant majority of candidates showed a good understanding of the impact of the movement on the statement of profit or loss and other comprehensive income. Workings provided by candidates were well laid out in a tabular format which facilitated the award of method marks.

Question 3.2: Candidate performance was mixed. This question required an understanding of how deferred tax is calculated and required the relevant journal entries to be posted. While some candidates performed well here, it was disappointing to note that a significant minority of candidates demonstrated an obvious lack of knowledge of deferred tax, making very little effort to provide any relevant workings.

Question 3.3: This question tested candidates' understanding of revenue recognition, inventory valuation, issue of shares at a premium and treatment of a dividend payment. Generally, candidate performance was good. It was pleasing to note that the majority of scripts contained detailed, labelled workings for each separate element of the question.

Question 3.1: CROSS

	Debit €/£ '000	**Credit** €/£ '000
Net pension liability (SOFP)		3,700
Defined benefit pension expense (SPLOCI – P/L) (1,200+1,000+18)	2,218	
Defined benefit pension remeasurement (SPLOCI – OCI)	1,482	
Bank (SOFP)		

<u>Movement in Net Pension Defined Benefit Liability</u>

	FV of plan assets €/£ '000	**PV of plan liabilities** €/£ '000	**Net Liability** €/£ '000	**Note**
Opening Balance	7,000	7,300	300	Op net liability
Current service cost		1,200	1,200	P/L Expense
Interest cost (op bal * 6%)	420	438	18	P/L Expense
Benefits paid out	(400)	(400)		
Contributions paid in	1,700		(1,700)	Already recorded
Past service cost		1,000	1,000	P/L Expense
Gains / losses on remeasurement				
Gain on assets *(Bal fig)*	280		(280)	OCI gain
Loss on liabilities *(Bal fig)*		1,762	1,762	OCI expense
Closing Balance	9,000	11,300	2,300	Clos net liability

<u>Summary of Movement in Net Defined Benefit (DB) Pension Liability</u>

		€/£ '000
Dr P/L	Net DB pension expense (current service cost)	1,200
Dr P/L	Net DB pension expense (net interest cost) (438 – 420)	18
Dr P/L	Net DB pension expense (past service cost)	1,000
Dr OCI	Net DB pension remeasurement losses (1,762 – 280)	<u>1,482</u>
Cr SOFP	Net DB pension liability (1,200+18+1,000+1,482)	3,700

Question 3.2: JAKE

	Debit €/£	Credit €/£
Deferred tax asset (SOFP)	65,000	
Deferred tax liability (SOFP)		100,000
Tax expense (SPLOCI – P/L)		65,000
Tax expense (SPLOCI – OCI)	100,000	

Workings

1. **Provision**

	Debit €/£	Credit €/£
Deferred tax asset (SOFP)	25,000	
Tax expense (SPLOCI – P/L)		25,000

The €/£ 100,000 is not recognised as a tax deductible expense in the current period although it has been recognised in JAKE's financial statements. The accounting profit is now lower than the taxable profit meaning a temporary timing difference of €/£ 100,000 exists. This gives rise to a deferred tax asset of €/£ 25,000 (€/£ 100,000*25%).

2. **Service Revenue**

	Debit €/£	Credit €/£
Deferred tax asset (SOFP)	40,000	
Tax expense (SPLOCI – P/L)		40,000

Revenue of €/£ 240,000 has been recognised in JAKE's profit or loss account. The carrying value of the deferred revenue liability at 31 December 2016 is €/£ 160,000 (€/£ 400,000 – €/£ 240,000). All €/£ 400,000 has been recognised as taxable income meaning the taxable profit is greater than the accounting profit. The deductible temporary difference of €/£ 160,000 creates a deferred tax asset of €/£ 40,000 (€/£ 160,000*25%). The asset can be recognised as JAKE has sufficient taxable profits against which to utilise the deductible temporary difference. It would be recognised as a current asset since the remaining revenue is recognised in the following accounting period.

3. **Land**

	Debit €/£	Credit €/£
Tax expense (SPLOCI – OCI)	100,000	
Deferred tax liability		100,000

As the unrealised gain on revaluation of the land is not taxable until sold, the tax base of the land is €/£ 3,000,000. The revaluation means accounting profits are greater than taxable profits giving rise to a taxable temporary difference of €/£ 400,000 (€/£ 3,400,000 – €/£ 3,000,000).

This creates a non-current deferred tax liability of €/£ 100,000 (€/£ 400,000 x 25%). As the unrealised gain is reported in other comprehensive income, the related deferred tax expense is also reported in other comprehensive income *(IAS 12.61A).*

Solution 3.3: KOLO

	Debit €/£	Credit €/£
Revenue (SPLOCI) (780,000 – 240,000)	540,000	
Trade receivables (SOFP)		780,000
Closing inventory (SOFP)	650,000	
Cost of sales (SPLOCI)		650,000
Discount allowed (SPLOCI)	15,000	
Administration expense (SPLOCI)		
Bank (SOFP) (225,000 + 5,400,000 – 636,000)	4,989,000	
Share capital (SOFP)		150,000
Share premium (SOFP)		5,250,000
Retained earnings (SOFP)	636,000	

Workings

1. **Sale and Early Settlement Discount**

	Debit €/£	Credit €/£
Cr Revenue (SPLOCI)		240,000
Dr Discount Allowed (SPLOCI)	15,000	
Dr Bank (SOFP)	225,000	
Being recognition of sale and early settlement discount		

Revenue is measured net of any trade or volume discount *(IAS 18.10)*. Hence, KOLO recognises revenue of €/£ 240,000 (€/£ 300,000 * 80%). The early settlement discount is not deducted from revenue. It is recognised as an expense in the financial statements of KOLO.

2. **Post Year End Sale**

Recognition of revenue from the sale of goods should occur when the revenue can be reliably measured and the transfer of risks and rewards of ownership have passed from the seller to the buyer *(IAS 18.14).* As the sale of goods took place in January 2017, it should not be recorded in the 31 December 2016 year-end financial statements. Hence, this needs to be reversed.

Also, the inventory should be included in the financial statements of KOLO at year-end. Inventory is valued at the lower of its cost and net realisable value *(IAS 2.9)*. Given a sales value of €/£ 780,000 and a mark-up of 20%, the cost of the inventory is €/£ 650,000 (€/£ 780,000 / 120 * 100). Accordingly, the value of KOLO's closing inventory should be increased by €/£ 650,000.

	Debit €/£	Credit €/£
Dr Revenue (SPLOCI)	780,000	
Cr Trade receivable (SOFP)		780,000
Being reversal of post year-end sale		
Dr Closing inventory (SOFP)	650,000	
Cr Cost of sales (SPLOCI)		650,000
Being restatement of year-end inventory		

3. Share Issue

KOLO has 6,000,000 shares in issue (€/£ 1,500,000 / 25 cents/pence). A one for ten rights issue means that an additional 600,000 shares are issued to shareholders. €/£ 9 is received for each share meaning total funds of €/£ 5,400,000 are raised.

The share capital account records the nominal value of each share (600,000 * 0.25 = €/£ 150,000) while the balance is recorded in the share premium account (600,000 * €/£ 8.75 = €/£ 5,250,000).

	Debit €/£	**Credit** €/£
Dr Bank	5,400,000	
Cr Share capital		150,000
Cr Share premium		5,250,000
Being recognition of share issue for cash		

4. Dividend Paid

The 31 January dividend payment was made when KOLO had six million shares in issue. Hence, this dividend payment totals €/£ 240,000 (6 million shares * 4 cents/pence per share). The 30 September dividend payment occurs after the rights issue giving rise to a payment of €/£ 396,000 (6.6 million shares * 6 cents/pence per share). In total KOLO has made an ordinary dividend payment of €/£ 636,000 during 2016.

	Debit €/£	**Credit** €/£
Dr Retained earnings (SOFP)	636,000	
Cr Bank (SOFP)		636,000
Being recognition of dividend payment		

End of suggested solution

