MARK PLAN AND EXAMINER'S COMMENTARY

The marking plan set out below was that used to mark this question. Markers were encouraged to use discretion and to award partial marks where a point was either not explained fully or made by implication. More marks were available than could be awarded for each requirement. This allowed credit to be given for a variety of valid points which were made by candidates.

Question 1

Total Marks: 33

General comments

Part (a) of this question tested the preparation of a statement of profit or loss and a statement of financial position from a trial balance plus a number of adjustments. Adjustments included an asset held for sale which had previously been revalued, a finance lease, the receipt of a government grant, an adjusting event after the reporting period and an income tax refund. Part (b) tested the difference between the IFRS treatment of the government grant and that under UK GAAP. Part (c) tested the definitions of the elements of financial statements with application to the financial statements prepared in Part (a).

Antigua plc

(a) Financial statements

Statement of profit or loss for the year ended 31 December 2014

	£
Revenue	8,417,010
Cost of sales (W1)	(4,799,960)
Gross profit	3,617,050
Operating expenses (W1)	(2,044,050)
Profit from operations	1,573,000
Finance cost (W7)	(1,750)
Profit before tax	1,571,250
Income tax expense (497,500 – 127,000)	(370,500)
Profit for the year	1,200,750

Statement of financial position as at 31 December 2014

	£	£
Assets		
Non-current assets		
Property, plant and equipment (1,271,600 + 283,090) (W2)		1,554,690
Current assets		
Inventories (W6)	733,400	
Trade and other receivables	578,700	
	1,312,100	
Non-current asset held for sale (58,000 – 5,000)	53,000	
		1,365,100
Total assets		2,919,790

Equity and liabilities	**£**	**£**
Equity		
Ordinary share capital		50,000
Revaluation surplus (W5)		717,400
Retained earnings (W4)		1,185,740
		1,953,140
Non-current liabilities		
Finance lease liabilities (W7)		33,500
Current liabilities		
Finance lease liabilities (W7)	9,250	
Trade and other payables	325,100	
Borrowings	101,300	
Taxation	497,500	
		933,150
Total equity and liabilities		2,919,790

Workings

(1) Allocation of expenses

	Cost of sales £	**Operating expenses £**
Per TB	4,741,400	2,017,500
Opening inventories	678,000	
Closing inventories (W6)	(733,400)	
Costs to sell held for sale asset		5,000
Loss on held for sale asset (W3)		800
Depreciation charge on buildings		30,000
Depreciation charges on plant and equipment (5,175 + 8,375 + 48,660 (W2))	62,210	
Add back government grant (103,500 x 50%)	51,750	
Lease payment wrongly included		(9,250)
	4,799,960	2,044,050

(2) PPE

	Land and buildings £	**Plant and equipment £**
B/f Valuation/Cost	1,490,000	578,000
B/f Accumulated depreciation	(90,000)	(231,200)
	1,400,000	346,800
Less: Held for sale asset (W3)	(98,400)	
Depreciation on buildings ((1,490,000 – 140,000) ÷ 45)	(30,000)	
Less government grant (W1)		(51,750)
Depreciation on equipment subject to grant (51,750 x 20% x 6/12)		(5,175)
Leased asset		50,250
Depreciation on leased asset (50,250 ÷ 6)		(8,375)
Depreciation on other plant and equipment ((346,800 – 103,500) x 20%)		(48,660)
	1,271,600	283,090

(3) Asset held for sale

	Asset	Revaluation surplus
	£	£
Cost on 1 January 2006	76,000	
Depreciation to 31 December 2010 (76,000/50 x 5)	(7,600)	
Carrying amount at 31 December 2010	68,400	
Revaluation on 1 January 2011	108,000	39,600
Depreciation to 31 December 2014 (108,000/45 x 4)	(9,600)	
Carrying amount at 31 December 2014	98,400	
Fair value	(58,000)	
	40,400	39,600
Charge to profit/revaluation surplus	800	(39,600)

(4) Retained earnings

	£
At 31 December 2013	(15,010)
Profit for the year	1,200,750
At 31 December 2014	1,185,740

(5) Revaluation surplus

	£
At 31 December 2013	757,000
Loss on held for sale asset (W3)	(39,600)
At 31 December 2014	717,400

(6) Closing inventories

	£
At cost	752,000
Less Write down to NRV ((142,000 x 70%) – 118,000)	(18,600)
	733,400

(7) Finance lease

	B/f	Payment	Capital	Interest	C/f
	£	£	£	£	£
31 December 2014	50,250	(9,250)	41,000	(5/15 x 5,250) 1,750	42,750
31 December 2015	42,750	(9,250)	33,500		

SOTD = (5 x 6)/2 = 15
Interest = (9,250 x 6) – 50,250 = 5,250

Generally candidates made a good attempt at this part of the question. However, presentation of the financial statements was often poor, and many scripts were messy and disorganised. It was noticeable that far less well-presented scripts than usual were seen. In particular it was often not possible to agree the figure taken to the statement of financial position for the carrying amount of property, plant and equipment to a single figure in the workings. Candidates should be aware that if such a figure cannot be seen in the workings then they will not gain the mark available for this figure on the face of the statement of financial position. In general, property, plant and equipment workings were often untidy and indicated that the approach to working out this figure was not methodical. The recommended approach is for candidates to use a property, plant and equipment "table" with supporting workings as needed.

Generally, candidates arrived at the correct figures for closing inventories, the income tax charge in the statement of profit and loss and the figure for non-current assets held for sale on the statement of financial position (with many candidates gaining the additional marks available for putting this in the correct place at the bottom of current assets). Many candidates made a good attempt at the workings in relation to the impairment on the asset held for sale, the most common errors being:

- a failure to revalue the asset to fair value first and therefore deal with the costs to sell separately
- errors in depreciation calculations (usually charging depreciation for an incorrect number of years)
- charging the whole of the impairment to the revaluation surplus, without first checking what the balance on the revaluation surplus in relation to the asset was
- charging the impairment to the revaluation surplus and the same figure as an expense in the statement of profit and loss
- having arrived at a figure for the carrying amount of the asset held for sale, failing to deduct this figure from property, plant and equipment, or deducting the fair value instead.

Surprisingly, the aspect of the question that caused the most problems was the finance lease. Usually, the majority of candidates would get the figures in relation to this completely correct, but, on this occasion, that was rare. Almost all candidates calculated a "sum of the digits" but this was often based on payments in arrears, rather than in advance, even where the candidate's lease "table" clearly showed payments in advance. Furthermore, a worrying number of candidates were unable to calculate the correct figure for total finance costs. Having calculated their own sum of the digits, some candidates then went on to use this as an interest rate in their leasing table. Finally, only a small number of candidates were able to correctly split the year-end liability, per their own table, into current and non-current, with few appreciating that for a lease where payments are in advance, the current liability will always be the payment for the next year.

Most candidates did use the recommended "costs matrix" when allocating costs for the statement of profit or loss, and entered the adjustments into the correct columns. Occasionally errors were made in terms of whether the adjustment was increasing or decreasing costs particularly with regard to the grant incorrectly credited to purchases. Candidates whose convention was to use figures in brackets for costs were generally the ones who got themselves into a muddle with the direction of their adjustments, as if they had reverted to the opposite convention part way through. A number of candidates failed to include all of their depreciation charges (on the leased asset, the asset subject to a grant, on the remaining plant and equipment, and on the building) in this matrix, even when they had calculated all of these elements in their property, plant and equipment workings. Once again, this indicated a disorganised approach.

Other common errors included the following:

- Showing the bank account (which was a credit balance in the trial balance) as a current asset, rather than as an overdraft in current liabilities.
- Adding the retained earnings brought forward (which was a debit balance in the trial balance) to their profit for the year, instead of deducting it.
- Reducing the income tax liability by the income tax refund when that refund had already been received (or showing the refund as a separate tax asset).
- Adding the grant to property, plant and equipment rather than deducting it.
- Charging a full year's depreciation on the asset subject to the grant, instead of six months.
- Using a useful life of seven years for the leased asset instead of the (shorter) lease term of six years.

Total possible marks	27
Maximum full marks	25

(b) Differences between IFRS and UK GAAP re government grant

UK GAAP	**IFRS**
Grants are recognised under the performance model or the accrual model. This policy choice is to be made on a class-by-class basis.	No such requirement exists in IAS 20.
Under the performance model, where no specific performance-related conditions are imposed on the recipient (as here) then the grant is recognised in income when the grant proceeds are received or receivable. Hence, if the performance model had been chosen, then Antigua Ltd would have credited the whole £51,750 to income during the year.	This would not be possible under IFRS, where, under the chosen netting-off method, the grant is credited against the cost of the asset and so effectively released to profit or loss over the life of that asset, in line with the depreciation policy on that asset.
Under the accrual model grants relating to assets are recognised in income on a systematic basis over the expected useful life of the asset. However, this cannot be done by deducting the grant from the carrying amount of the asset, but by recognising deferred income.	

Most candidates made a reasonable attempt at this part of the question, with almost all stating that IFRS allows a choice of treatment, but that UK GAAP only allows the deferred income method. Most went on to clearly describe the mechanics of the two methods, although some wasted time providing calculations for the deferred income method, which were not required. Very few candidates gained full marks, and almost all candidates seemed unaware of the two models (performance and accrual) allowed by UK GAAP.

Total possible marks	6
Maximum full marks	3

(c) Elements of the financial statements

Asset – The finance lease is recognised as an asset because the machine is controlled by Antigua plc (has the risks and rewards), the control came about via the signing of the lease, which happened during the year, and the machine will be used in the business to generate future revenue.

Liability – The overdraft is recognised as a liability because it existed at the year end and will lead to future outflows in the form of repayment and interest payments.

Income – Revenue is a form of income as it brings cash inflows or enhancement of assets in the form of trade receivables.

Expenses – Depreciation is an expense as it reduces the carrying amount of property, plant and equipment (ie depletes an asset).

Equity – this equals Antigua plc's ordinary share capital, retained earnings and revaluation surplus as the sum of these is equal to total assets minus total liabilities/is the residual interest in the assets of the entity after deducting all its liabilities.

There were some very good attempts at this part of the question, with all five elements clearly stated, an appropriate example given for each, and a clear explanation of why the given example met the definition. At the other end of the scale were answers which, although they gave the five elements and appropriate examples, merely copied out the definitions of the elements from the open book text, without any attempt to relate those definitions to their examples, and therefore scored very little for their explanations. A significant minority of candidates confused "elements" with the fundamental and enhancing qualitative characteristics, thereby scoring no marks.

Total possible marks	8½
Maximum full marks	5

Question 2

Total Marks: 28

General comments

Part (a) of this question required candidates to explain the IFRS financial reporting treatment of the four issues given in the scenario. The issues covered a financial asset, the disposal of a subsidiary, a foreign exchange transaction and a related party transaction. Part (b) required a discussion of the ethical issues arising from the scenario and the action to be taken. Part (c) required candidates to describe any differences between IFRS and UK GAAP in respect of the financial reporting treatment of Issue (2).

Cuba Ltd

(a) IFRS financial reporting treatment

(1) Financial asset

The bond is a financial asset as defined by IAS 32, Financial Instruments: Presentation, because it represents a contractual right to receive cash from another entity.

Per IAS 39, Financial Instruments: Recognition and Measurement, financial assets should be recognised when the contract is entered into and initially measured at its fair value, including transaction costs. Fair value is defined by IFRS 13, Fair Value Measurement, but is normally the transaction price.

Hence Philippe was correct to recognise the asset on 1 January 2014, but should have recognised it at £97,000 (94,500 + 2,500), not £110,000. As this is a held-to-maturity financial asset, the asset should subsequently be measured at amortised cost using the effective interest method.

At 31 December 2014 interest of £6,295 (97,000 x 6.49%) should be recognised as income in profit or loss so the income recognised of £15,500 will need to be reduced by £9,205 (15,500 – 6,295). The bond should be stated at £103,295 (97,000 + 6,295). Because the bond is redeemable on 31 December 2015, ie within one year, it should be presented in investments within current assets.

(2) Disposal of subsidiary

In Cuba Ltd's consolidated financial statements the profit on disposal of Honduras Ltd should be calculated by comparing the net assets at the date of disposal and non-controlling interest (NCI), less goodwill on consolidation not already written off, to the sale proceeds. The net assets at the date of disposal will be the net assets brought forwards on 1 January 2014, less the loss earned by Honduras Ltd to the date of disposal/(six months pro-rated).

		£	£
Sale proceeds			256,600
Less:	Carrying amount of goodwill at date of disposal:		
	Consideration transferred at date of acquisition	147,800	
	Fair value of NCI at date of acquisition	40,100	
		187,900	
	Net assets as date of acquisition	(157,500)	
	Goodwill at date of acquisition and disposal		(30,400)
	Carrying amount of goodwill at date of disposal:		
	Net assets on 31 December 2013	301,000	
	Loss for current year to date of disposal (16,600 ÷ 2)	(8,300)	
	Carrying amount of net assets at date of disposal		(292,700)
Add:	NCI in net assets at date of disposal (40,100 + (292,700 – 157,500) x 20%))		67,140
Profit on disposal			640

This figure should be recognised in the consolidated statement of profit or loss as discontinued operations. In the consolidated statement of profit or loss, Cuba Ltd should include the results of Honduras Ltd up to the date of disposal. At the year end of 31 December 2014 the Cuba Ltd group no longer controls any of the assets or liabilities of Honduras Ltd and so the consolidated statement of financial position should not recognise any of Honduras Ltd's assets or liabilities.

The non-controlling interest figure will similarly include their share (20%) of six-twelfths of Honduras Ltd's loss for the year, being £1,660 (16,600 x 20% x 6/12). In the statement of changes of equity for the year the £67,140 above will be shown as a deduction in the non-controlling interest column.

Because the investment in Honduras Ltd represented a separate major line of business of the Cuba Ltd group, in the consolidated statement of profit or loss, the results of Honduras Ltd for the year ended 31 December 2014 should be presented separately in accordance with IFRS 5, Non-current Assets Held for Sale and Discontinued Operations. A single net figure of a loss of £7,660 for the discontinued operation should be disclosed on the face of the consolidated statement of profit or loss, being the profit on disposal of £640, less the loss for the period to disposal of £8,300. A disclosure note should show the breakdown of this figure into revenue, costs and the profit on disposal. Honduras Ltd's prior period results should be reclassified as discontinued in order to ensure comparability.

(3) Foreign exchange transaction

IAS 21, The Effects of Changes in Foreign Exchange rates, states that a foreign currency transaction should be recorded, on initial recognition in the functional currency, by applying the exchange rate between the reporting currency and the foreign currency at the date of the transaction/historic rate. When the goods were received on 23 November 2014, Philippe was correct to record them in purchases and trade payables at the spot rate of €1:£0.85, ie at an amount of £134,300 (158,000 x 0.85).

However, at the year end, IAS 21 requires that any foreign currency monetary items are retranslated using the closing rate. Monetary items are defined as "units of currency held and assets and liabilities to be received or paid in fixed or determinable number of units of currency". The trade payable in respect of this purchase meets the definition of a monetary item and should have been retranslated at the closing rate. This would have given a trade payable of £142,200 (158,000 x 0.90). This exchange loss of £7,900 (142,200 – 134,300) should have been included in the consolidated statement of profit or loss for the year ended 31 December 2014.

Furthermore, because inventory does not meet the definition of a monetary item, it should have been left as originally recorded, and not been restated. Closing inventory therefore should be reduced by the same amount (£7,900), further reducing the profit for the year.

(4) Related party transaction

This appears to be a related party transaction per IAS 24, Related Party Disclosures. Grenada Ltd is a related party of Cuba Ltd because Grenada Ltd is owned by a close family member of Cuba Ltd's key management personnel (ie it is owned by the wife of Cuba Ltd's finance director).

The following disclosures are therefore required, even if the purchases were indeed made on an arm's length basis:

- The nature of the related party relationship (ie that purchases have been made from a company owned by the finance director's wife).
- The amount of the transactions (£550,000).
- The amount of any balances outstanding at the year-end (£75,000).

Disclosure may be made of the fact that the transactions were made on an arm's length basis if this can be substantiated.

This question was not answered as well as the numeric parts of the paper, and indeed the other written parts. Candidates need to be aware that they can only score well on this type of question if they make a reasonable attempt to provide explanations, in addition to calculations.

Issue (1): This was generally very poorly answered with many candidates assuming this was a liability. Given that the bond was "purchased" as opposed to being "issued" it was clearly a financial asset, not a financial liability. Others thought it was a compound financial instrument, with equity and liability components. Some hedged their bets altogether by stating it was both an asset and a liability. A few thought it was an intangible asset. Others provided figures (some sort of amortised cost table) without ever stating what the transaction represented. Those candidates who did correctly identify the transaction as a financial asset generally said that it needed to be recognised at an initial £97,000 (ie including the transaction costs) and then amortised that figure at its effective interest rate, giving a closing carrying amount, although the answer did not always describe that method in words.

Issue (2): Much better attempts were made at this part of the question. Almost all candidates recognised this as a discontinued operation, although they didn't always explicitly state this, and correctly stated that it needed to be recognised as a single line in the statement of profit or loss. They then correctly combined their own figure for profit or loss on disposal with the subsidiary's loss for the year up to disposal. Most recognised that the loss for the year was for six months only, but a significant number of candidates, as usual, took only the group share of this figure. However, although almost all candidates attempted the relevant calculations, many, once again, failed to also describe what needed to be done in words. Few considered the impact of the disposal on the statement of financial position (ie the subsidiary would not be consolidated as control had been lost). By far the most common error in the calculation of the profit or loss on disposal was in respect of the non-controlling interest at disposal with very few calculating this using the chosen fair value policy – most candidates calculated this using the proportionate method and therefore simply took 20% of the net assets at disposal. Others made errors in the calculation of the latter figure, most commonly adding, rather than deducting, the loss for the year from the opening net assets.

Issue (3): Once again, many candidates produced the correct relevant calculations (this time often accompanied by journal entries, which were not required) without explaining why it was that the payable needed to be restated but that the inventory should not have been (ie making reference to the treatment of monetary, as opposed to non-monetary items). A minority of candidates said that the inventory had correctly been restated and that the payables correctly left at the historic rate. A significant number of candidates, whilst producing the three correct figures, seemed to be completely unclear as to which figures should be shown at which amount, ie at the historic or closing rate.

Issue (4): Most candidates recognised that this was a related party transaction and were able to explain why. However, most said that this was because Phillippe's wife was a related party, as opposed to Cuba Ltd being a related party. Almost all candidates listed the necessary disclosure requirements but fewer illustrated how these requirements would be fulfilled by reference to the information in the scenario. Most knew that the fact that the transaction had been made on an arm's length basis did not negate the need for disclosure.

Total possible marks	33
Maximum full marks	21

(b) Ethical issues

Philippe appears to have a self-interest threat, as he is due a bonus based on the profit for the year. The "errors" which José has discovered in the draft financial statements could be genuine mistakes due to a lack of knowledge, or could be a deliberate attempt by Philippe to overstate the profit for the year in order to increase his bonus. It may be that had it not been for his illness that these "errors" would not have been discovered.

As an ICAEW Chartered Accountant Philippe has a duty of professional behaviour and due care and should be aware of the correct IFRS financial reporting treatment for all of these issues, none of which are at all controversial. His imminent retirement is no excuse.

Although the transaction with Grenada Ltd may all be above board, it does perhaps throw into doubt the integrity of Philippe if there is any question over whether the transactions were conducted on an arm's length basis. In any case, even if they were, as an ICAEW Chartered Accountant Philippe should not only act with integrity but he should *appear* to act with integrity. The fact that he is suggesting that this transaction does not need to be disclosed also paints him in a poor light.

Given Phillippe's attitude about not amending the figures, José is subject to an intimidation threat. He should apply the ICAEW Code of Ethics, with the following programme of actions:

- Explain to Philippe how each of these matters should be accounted for.
- If Philippe refuses to correct the errors, discuss the matters with the other directors to explain the situation and obtain support. Consider also discussing the issues with the external auditors.
- Obtain advice from the ICAEW helpline or local members responsible for ethics.
- Keep a written record of all discussions, who else was involved and the decisions made.

This part of the question was well answered. Most candidates correctly identified that there was a self-interest threat for Phillippe (because of his profit-related bonus) and that there was an intimidation threat for José (due to Phillippe's attitude in the telephone call). They also recognised that all of the "errors" had increased the profit for the year. Many then went on the discuss the actions that José should take, being the standard response of discussion with Phillippe, discussion with the other/managing director(s), seeking help from the ICAEW helpline, and documenting all discussions. As ever, many candidates were overly keen to resign and a number put themselves in an audit context, by suggesting that they should seek help from the ethics partner.

Total possible marks	9
Maximum full marks	5

(c) IFRS v UK GAAP differences re disposal of subsidiary

IFRS	**UK GAAP**
IFRS 5 requires the results of a discontinued operation to be shown as a single figure on the face of the statement of profit or loss.	FRS 102 shows the results of a discontinued operation as a separate column on the face of the income statement.
Under IFRS 3 non-controlling interest may be measured at fair value or on the proportionate basis.	FRS 102 only permits the proportionate (share of ownership) basis.
IFRS 3 goodwill is not amortised but is subject to annual impairment reviews.	FRS 102 requires goodwill to be amortised over its useful life. There is a rebuttable presumption that the useful life should not exceed five years.

Almost all candidates scored at least one mark in this part, with the most common answer being to describe the differences between the presentation of discontinued activities in the statement of profit or loss/income statement, which was understandable as this was the main focus of Issue (2). However, Issue (2) also covered the calculation of goodwill and candidates should have been guided by the fact that the requirement was for two marks and that therefore they needed to think more widely and look at the calculation itself. Some candidates did go on to do this and achieve a second mark by describing which methods of calculating goodwill and the non-controlling interest are available under IFRS and UK GAAP. It was less common to see the differences with reference to the impairment and amortisation of goodwill, although this was not needed to achieve full marks.

Total possible marks Maximum full marks	3½ 2

Question 3

Total Marks: 19

General comments

This was a mixed topic question requiring the preparation of extracts from the financial statements. The question featured various transactions in property, plant and equipment, including a self-constructed asset, in addition to share issues during the year and dividends. In Part (a) candidates were required to explain their treatment of the self-constructed asset, which meant they could then use their calculated figures in Part (b).

Columbia plc

(a) IFRS financial reporting treatment of the manufacturing facility

Per IAS 16, Property, Plant and Equipment, the cost of an item of property, plant and equipment (PPE) comprises:

- Purchase price
- Costs directly attributable to bringing the asset to its intended location and condition.

The site preparation costs, materials and labour costs, professional fees, construction overheads and costs of the initial safety inspection are directly attributable costs and therefore can be capitalised, a total of £500,300 (100,000 + 358,300 + 10,000 + 21,000 + 11,000).

The relocation costs of £45,600 and the general overhead costs of £32,500 cannot be capitalised/should be expensed because they are not directly attributable. So the total amount written off to profit or loss should be £78,100 (45,600 + 32,500).

Capitalisation should cease when the asset becomes capable of operating in the manner intended /so on 30 November 2014.

Each significant part of an item of PPE should be depreciated separately so the calculation of the annual depreciation charge for the year will be:

	£
Safety inspection (21,000 ÷ 3)	7,000
Other ((500,300 – 21,000) ÷ 20)	23,965
	30,965

Since the asset was available for use only from 30 November 2014, then only one month of this annual charge should be recognised in profit or loss for the year ended 31 December 2014, ie £2,580 (30,965 ÷ 12).

The carrying amount of the facility on 31 December 2014 is therefore £497,720.

Answers to this part were mixed, although a reasonable number of candidates did obtain the maximum marks and, generally, the quality of explanations in this part was better than those in Part (a) of Question 2. However, a significant number of candidates wasted time by discussing irrelevant accounting standards, in particular IAS 38, Intangible Assets and IAS 23, Borrowing Costs. Most candidates made an attempt at justifying which costs should and shouldn't be capitalised and virtually all candidates did conclude that a month's worth of depreciation should be charged and attempted to calculate this figure. The most common errors were:

- failing to justify the appropriate treatment for the costs by reference to IAS 16, Property, Plant and Equipment
- treating the professional fees and/or the construction overheads and/or the initial safety inspection costs incorrectly
- not separating out the initial safety inspection costs so that they could be depreciated over the shorter life of three years.

Total possible marks	7½
Maximum full marks	5

(b) (i) Revised profit for the year ended 31 December 2014

	£
Draft profit for the year	52,600
Costs re self-constructed asset (a)	(78,100)
Depreciation on self-constructed asset (a)	(2,580)
Finance costs (50,000 x 4% x ½)	(1,000)
	(29,080)

(ii) Extracts from the financial statements for the year ended 31 December 2014

Statement of cash flows for the year ended 31 December 2014

	£
Investing activities	
Purchase of property, plant and equipment (W1)	(932,800)
Proceeds from sale of property, plant and equipment (125,700 – 14,300)	111,400
Financing activities	
Issue of ordinary share capital (75,000 x 1.50)	112,500
Issue of irredeemable preference share capital	50,000
Ordinary dividends paid (W2))	(56,250)

Statement of financial position as at 31 December 2014

	£
Non-current assets	
Property, plant and equipment (W1)	2,025,620
Equity	
Ordinary share capital (W3)	468,750
Retained earnings (W2)	39,220
Non-current liabilities	
Irredeemable preference share capital	50,000
Current liabilities	
Preference dividend/finance costs payable	1,000

Workings

(1) PPE

	£		£
B/d	1,456,700	Disposal	125,700
Additions (432,500 + 500,300 (a))	932,800	Depreciation (235,600 + 2,580 (a))	238,180
		C/d (β)	2,025,620
	2,389,500		2,389,500

(2) Retained earnings

	£		£
Loss for the year (i)	29,080	B/d	145,800
Bonus issue (93,750 – 72,500) (W3)	21,250		
Ordinary dividend (15p x 375,000)	56,250		
C/d (β)	39,220		
	145,800		145,800

(3) Ordinary share capital and share premium

	Share capital £	Share premium £
At 31 December 2013	300,000	35,000
Issue on 1 February 2014	75,000	37,500
	375,000	72,500
Bonus issue on 1 November 2014 (÷ 4)	93,750	(72,500)
At 31 December 2014	468,750	-

Generally answers to this part were good with most candidates calculating an adjusted profit figure and preparing extracts to both the statement of financial position and statement of cash flows. The quality of extracts produced was reasonable, but a minority of candidates produced a jumble of notes and workings.

Many candidates correctly calculated the closing balance on the share capital account and showed in their workings that the share premium account would be reduced to zero. The figures for proceeds from disposals of property, plant and equipment, issue of shares and dividends paid were also dealt with well and nearly always shown under the correct heading in the statement of cash flows. However, as always with the statement of cash flows, many candidates lost marks for failing to show outflows of cash in brackets. This is an issue that has been flagged up repeatedly. Also, many candidates wasted time by duplicating workings; often doing a bracketed working for property, plant and equipment to calculate the figure for the statement of financial position then also producing a T-account working (which often included different numbers). Another common error with property, plant and equipment was to include the costs of the new manufacturing facility in the working but not in the figure on the face of the statement of cash flows. Other candidates wasted time by preparing a combined share capital and share premium T-account then had to repeat the working, showing these accounts separately, to allow for the preparation of statement of financial position extracts. A worrying minority of candidates calculated a weighted average number of ordinary shares, as would be needed for an earnings per share calculation.

Other common errors included:

- including a full year for the dividend on the irredeemable preference shares (rather than six months) and also treating it as a dividend paid on the statement of cash flows, or omitting this dividend entirely
- making unnecessary adjustments to both profit and property, plant and equipment (when the question clearly stated that the depreciation on existing assets and the loss on the disposal had already been recognised)
- deducting all of the bonus issue from retained earnings when as much of it as possible should have been taken to share premium (another reason why it was necessary to produce separate share capital and share premium workings)
- calculating the ordinary dividend by reference to closing share capital (when the bonus issue had not been made until after the interim dividend was paid)
- combining the liabilities for the preference dividend payable with the preference share capital in the statement of financial position, rather than showing these individually as current and non-current liabilities respectively.

Total possible marks	14½
Maximum full marks	14

Question 4

Total Marks: 20

General comments

This question required the preparation of a consolidated statement of financial position from a draft version of the same, where figures for a subsidiary had been incompletely incorporated and figures for an associate not included at all. Fair value adjustments were required on acquisition for both companies as well as dealing with contingent consideration for the subsidiary. Intra-group trading and the transfer of a non-current asset had occurred during the year and also needed to be adjusted for.

Dominica plc

Consolidated statement of financial position as at 31 December 2014

	£	£
Assets		
Non-current assets		
Property, plant and equipment (3,780,400 – 20,000 (W7))		3,760,400
Investment in associate (W4)		160,060
Goodwill (W2)		108,830
		4,029,290
Current assets		
Inventories (400,800 + 8,500 (W1) + 17,700 (W1))	427,000	
Trade and other receivables	182,400	
Cash and cash equivalents	53,400	
		662,800
Total assets		4,692,090
Equity and liabilities		
Equity		
Ordinary share capital (1,400,000 – 160,000)		1,240,000
Share premium (890,000 – 80,000)		810,000
Revaluation surplus (1,061,600 – 240,000 + (100,000 (W1) x 85%))		906,600
Retained earnings (W5)		1,228,835
Attributable to the equity holders of Dominica plc		4,185,435
Non-controlling interest (W3)		103,155
		4,288,590
Current liabilities		
Trade and other payables (320,000 – 200,000)	120,000	
Contingent consideration	150,000	
Taxation	133,500	
		403,500
Total equity and liabilities		4,692,090

Workings

(1) Net assets – Tobago Ltd

	Year end £	Acquisition £	Post acq £
Ordinary share capital	160,000	160,000	-
Share premium	80,000	80,000	-
Revaluation surplus	240,000	140,000	100,000
Retained earnings	181,500	63,200	
FV adj – inventories ((124,000 – 107,000)/2)	8,500	17,000	
Inventory – sale or return (23,600 x 75%)	17,700	-	127,500
	687,700	460,200	227,500

(2) Goodwill – Tobago Ltd

	£
Consideration transferred:	
Cash	400,000
Contingent consideration	100,000
	500,000
Net assets at acquisition (W1)	(460,200)
Non-controlling interest at acquisition (460,200 (W1) x 15%)	69,030
	108,830

(3) Non-controlling interest – Tobago Ltd

	£
Share of net assets at acquisition (460,200 (W1) x 15%)	69,030
Share of post-acquisition profits (227,500 (W1) x 15%)	34,125
	103,155

(4) Investment in associate – Anguilla Ltd

	£
Cost	156,000
Add: Share of post-acquisition profits ((168,100 – 104,500) x 35%)	22,260
Less: FV depreciation (100,000/20 years) x 35% x 10 years)	(17,500)
Less: PURP (W6)	(700)
	160,060

(5) Retained earnings

	£
Draft consolidated (1,367,900 – 181,500)	1,186,400
Additional contingent consideration	(50,000)
Tobago Ltd (127,500 (W1) x 85%)	108,375
Anguilla Ltd (W4)	22,260
Less: FV depreciation (W4)	(17,500)
Less: PURP (W6)	(700)
Less: PPE PURP (W7)	(20,000)
	1,228,835

(6) PURP

	%	Anguilla Ltd £
SP	100	20,000
Cost	(70)	14,000
GP	30	6,000
X 1/3		2,000
Anguilla Ltd x 35%		700

(7) PPE PURP

	£
Asset now in Tobago Ltd's books at 180,000 x 5/6 years	150,000
Asset would have been in Dominica plc's books at 156,000 x 5/6 years	(130,000)
	20,000

Answers to this question were generally good, with virtually all candidates recognising that the associate should not be consolidated and that the equity balances needed to be adjusted to remove the figures of the subsidiary that had been incorrectly added in. Most candidates produced the standard workings used in the learning materials which meant it was relatively straightforward to follow the workings and give credit where appropriate. The correct figure for the unrealised profit relating to the associate was frequently calculated correctly although, as always, some candidates failed to use only the parent's share of this. Many candidates also seemed confused about what should be included in the associate working, often adding in fair value adjustments and not understanding that adjustments to the cost of the associate should also be included in retained earnings. A number of candidates calculated different figures for these two workings thereby wasting time and losing marks.

The two adjustments that caused the most problems were the unrealised profit relating to the sale of a machine and the adjustment to inventory for goods sold on a sale or return basis. With regard to the former those candidates who calculated the adjustment by comparing the two different carrying amounts did well. However, those who calculated separate figures for profit on disposal and the adjustment to the subsequent depreciation charge rarely netted these off to come to the correct adjustment. Some candidates calculated the relevant figure but then failed to adjust property, plant and equipment for this.

Few candidates calculated the correct adjustment for the goods on sale and return often adjusting for the profit element (which had not been recognised) rather than calculating the cost of the goods and adding it to net assets and inventories. The contingent consideration was also poorly dealt with. Many candidates used the wrong figure in the goodwill calculation and few made the appropriate corresponding adjustment to liabilities or dealt with the change in the value of the contingent consideration in retained earnings.

As always, many candidates lost marks by failing to show an "audit trail" so figures appeared in workings without any evidence of how they had been calculated. It is not sufficient to say, for example, "85% x NA at acq". The actual figure for net assets at acquisition (as calculated in the candidate's own net assets table) must also clearly be shown alongside the percentage for the marks to be awarded.

Other common errors included the following:

- Deducting, rather than adding, the fair value increase relating to inventory and/or failing to recognise that half the inventory had been sold by the year end.
- Adopting an inconsistent treatment in the net asset working and the adjustment to inventories in respect of the above (eg adding the figure to net assets but deducting it from inventories).
- Not separating out the movement in net assets relating to the revaluation surplus and therefore including this in retained earnings.
- Not adjusting the revaluation surplus to take into account only the parent's share of the subsidiary's post-acquisition movement on its revaluation surplus – many candidates added in 100% of this figure, others did not adjust for it at all.
- Not knowing how to calculate and/or account for the post-acquisition depreciation on the fair value uplift in the associate. A significant number of candidates who were able to calculate the depreciation adjustment then only proceeded to account for one year's worth of the adjustment instead of the required ten years' worth.
- Using 80% when calculating figures for the subsidiary, instead of the 85% given in the question.

Total possible marks	22
Maximum full marks	20