Accounting Technicians Ireland

Advanced Financial Accounting New Syllabus

2nd Year Examination

May 2016

Exam Paper, Solutions & Examiner's Comments

NOTES TO USERS ABOUT THESE SOLUTIONS

The solutions in this document are published by Accounting Technicians Ireland. They are intended to provide guidance to students and their teachers regarding possible answers to questions in our examinations.

Although they are published by us, we do not necessarily endorse these solutions or agree with the views expressed by their authors.

There are often many possible approaches to the solution of questions in professional examinations. It should not be assumed that the approach adopted in these solutions is the ideal or the one preferred by us. Alternative answers will be marked on their own merits.

This publication is intended to serve as an educational aid. For this reason, the published solutions will often be significantly longer than would be expected of a candidate in an examination. This will be particularly the case where discursive answers are involved.

Accounting Technicians Ireland

2nd Year Examination: Summer 2016

Paper: Advanced Financial Accounting
<u>NEW SYLLABUS</u>

Monday 9 May 2016
2.30 p.m. to 5.30 p.m.

INSTRUCTIONS TO CANDIDATES

PLEASE READ CAREFULLY

Candidates must indicate clearly whether they are answering the paper in accordance with the law and practice of Northern Ireland or the Republic of Ireland.

In this examination paper the €/£ symbol may be understood and used by candidates in Northern Ireland to indicate the UK pound sterling and the €/£ symbol may be understood by candidates in the Republic of Ireland to indicate the Euro.

Answer ALL THREE questions in Section A and TWO of the THREE questions in Section B. If more than TWO questions are answered in Section B, then only the first TWO questions, in the order filed, will be corrected.

Candidates should allocate their time carefully.

All workings should be shown.

All figures should be labelled, as appropriate, e.g. €'s, £'s, units etc.

Answers should be illustrated with examples, where appropriate.

Question 1 begins on Page 2 overleaf.

SECTION A

Answer ALL THREE Questions in this Section

QUESTION 1

(a) Write a paragraph on each of the following concepts;

(i) Historical Cost Concept
(ii) Prudence Concept
(iii) Going Concern Concept

12 Marks

(b) Discuss the importance of the "Accruals Concept" in financial statements reporting and give an example of its application in practice.

4 Marks

(c) FRS 102 provides that the presentation and classification of items in financial statements be consistent from one period to the next unless a change is justified by circumstances or is required by a new accounting standard.

What would the impact on Financial Statements reporting be, if the presentation of financial statements was allowed to change on a regular basis without restriction.

4 Marks
Total 20 Marks

QUESTION 2 *(Compulsory)*

The following multiple choice question consists of TEN parts, each of which is followed by FOUR possible answers. There is ONLY ONE right answer in each part.

Each part carries **1 ½ Marks**.

Requirement

Indicate the right answer to each of the following ten parts.

Total 15 Marks

Candidates should answer this question by ticking the appropriate boxes on the special answer sheet which is contained within the answer booklet.

1. In accordance with FRS 102 – Section 10 "Accounting Policies, Estimates and Errors", which of the following statements is correct:
   (a) An accounting policy should be changed if management consider it more favourable for the shareholders of the company.
   (b) An accounting policy should be changed if required to do so by a Financial Reporting Standard (FRS).
   (c) An accounting policy should never be changed
   (d) An accounting policy should be reviewed and changed annually

2. On 1st July 2015, a company that prepares financial statements to 30th June each year acquires an item of equipment at a cost of €/£75,000. The item's useful life is expected to be 4 years with a residual value of €/£15,000. The depreciation charge in year <u>three</u> using the straight line method of depreciation is:
   (a) €/£30,000
   (b) €/£15,000
   (c) €/£18,000
   (d) €/£12,000

3. Using the same information as in question 2, the depreciation charge in year <u>three</u> using the reducing balance method of depreciation (at a rate of 30%) is:
   (a) €/£22,500
   (b) €/£18,000
   (c) €/£11,025
   (d) €/£8,820

4. In accordance with FRS 102, a complete set of financial statements must include five items, which of the following is not one of those items:
   (a) A statement of Cash Flow
   (b) A statement of Changes in Equity
   (c) Notes including significant accounting policies and other explanatory notes
   (d) A cash flow forecast

5. In accordance with FRS 102 section 17 *Property Plant and Equipment*, which of the following is not included in the cost of an asset:
   (a) Transport costs
   (b) Non-refundable import duties and taxes
   (c) Administration costs
   (d) Professional fees

6. The draft profit of Omega Plc. for the year ended 31st December 2014 is €/£100,000. The following information is also available for which no adjustments has been reflected in the company's draft profit for the year;

   - In December, all of the company's assets were re-valued. The surplus on revaluation amounted to €/£50,000.
   - A fire occurred in the company's main warehouse just after the year-end destroying inventory worth €/£40,000.
   - A warehouse surplus to requirements was sold just before the year-end making a gain of €/£30,000.

   After making the appropriate adjustments for the above items in accordance with FRS 102, the profit before tax is;
   (a) €/£130,000
   (b) €/£80,000
   (c) €/£40,000
   (d) €/£70,000

7. A company prepares financial statements to 31st December 2014. The accounts are to be approved by the Board of Directors on 4th March 2015. On 22nd January 2015 an item of equipment shown as an asset in the Statement of Financial Position at 31st December 2014 was sold. According to FRS 102 – section 32 "Events After the end of the Reporting Period":

(a) This is an adjusting event and the Financial Statements need to be adjusted.
(b) This is a non-adjusting event but may be disclosed in the notes to the Financial Statements if of material value.
(c) This is an adjusting event and should be disclosed in the notes to the Financial Statements.
(d) This is an adjusting event but is immaterial in nature.

8. Which one of the following statements is always true?

(a) The company's reserves are represented by bank balances.
(b) The auditors of a company produce the financial statements.
(c) The directors of a company own the company.
(d) The shareholders of a company own the company.

9. In accordance with FRS 102 – section 7 "Statement of Cash Flow " the cost of non - current asset additions should be shown under which heading:

(a) Investing activities
(b) Operating activities
(c) Financing activities
(d) Working capital activities

10. Under FRS 102, dividends paid;

(a) Are included as an expense on the face of the Statement of Comprehensive Income.
(b) Are included as an appropriation on the face of the Statement of Comprehensive Income.
(c) Are included as an exceptional item on the Statement of Comprehensive Income.
(d) Are included as an appropriation on the Statement of Changes in Equity.

QUESTION 3

The following trial balance has been extracted from the books of YYY Ltd. as at 31st March 2015.

	€/£	€/£
Land at cost	720,000	
Buildings at cost	250,000	
Equipment at cost	206,000	
Vehicles at cost	284,000	
Accumulated depreciation at 1st April 2014:		
Buildings		90,000
Equipment		86,000
Vehicles		132,000
Inventory at 1st April 2014	107,000	
Trade receivables and payables	183,000	117,000
Allowance for receivables		8,000
Bank balance		63,000
Ordinary shares at €/£1 each		200,000
Retained earnings at 1st April 2014		803,000
Turnover		1,432,000
Purchases	488,000	
Director's fees	150,000	
Wages and salaries	276,000	
General distribution costs	101,000	
General administration expenses	186,000	
Dividend paid	20,000	
Rents received		30,000
Disposal of vehicle		10,000
	2,971,000	2,971,000

The following information is also available

1. The company's depreciation policy is as follows:
   Buildings: 4% p.a. Straight-line
   Equipment 40% p.a. Reducing balance
   Vehicles 25% p.a. Straight-line

In all cases, a full year's depreciation is charged in the year of acquisition and none in the year of disposal. None of the assets had been fully depreciated by 31st March 2014.
On 1st February 2015, a vehicle used entirely for administrative purposes was sold for €/£10,000. The sale proceeds were banked and credited to a disposal account but no other entries were made in relation to this disposal. The vehicle had cost €/£44,000 in August 2011. This was the only disposal of a non-current asset made during the year to 31st March 2015.

2 Depreciation is apportioned as follows:

	Distribution costs	Administrative expenses
Buildings	50%	50%
Equipment	25%	75%
Vehicles	70%	30%

3 The company's inventory at 31st March 2015 cost €/£160,000. However this included items of inventory with a cost of €/£41,000 which were actually worthless.

4. Trade receivables include a debt of €/£18,000 that is to be written off. The allowance for receivables is to be adjusted to 4% of the receivables which remain after this debt is written off.

5. The corporation tax liability for the year to 31st March 2015 is estimated to be €/£30,000.
6. One-quarter of wages and salaries were paid to distribution staff and the remaining three-quarters were paid to administrative staff.
7. General administrative expenses include bank overdraft interest of €/£5,000.
8. A dividend of 10c per ordinary share was paid on 31st December 2014. No further dividends are proposed for the year to 31st March 2015.

Required

Prepare the following financial statements for YYY Ltd. in accordance with the requirements of FRS 102:

(a) A Statement of Comprehensive Income for the year to 31st March 2015

8 Marks

(b) A Statement of Financial Position as at 31st March 2015.

7 Marks

(c) A Statement of Changes in Equity for the year to 31st March 2015.

4 Marks

(d) The Accounting Policy note in relation to Non – Current assets and depreciation.

4 Marks

Presentation 2 Marks

Total 25 Marks

SECTION B

Answer TWO of the THREE questions in this Section

QUESTION 4

Eatwell Ltd operates a chain of restaurants and is finalising its financial statements for the year ended 31 December 2015.

(i) The financial statements for 2014 included a provision of €/£50,000 for remedial work required on certain restaurant equipment. No remedial work was carried out during 2015 and prior to 31 December 2015, it was confirmed that the remedial work was not required and no liability would be incurred in respect of it.

(ii) One of the restaurants operates from a premises leased under an operating lease. During 2015, the restaurant sub-let part of the premises on a month by month basis to an adjacent business which uses the space for storage. The rent received from the sub-letting in 2015 was €/£1700.

(iii) During 2015, a customer successfully sued the company and was awarded damages of €/£37.500, due to a fall in one of the restaurants in 2015 which resulted in the customer breaking his arm. Legal costs associated with the claim which the company is also liable for is estimated at €/£12,000. The company has not yet paid the amount awarded or any element of the legal costs and has not included any record of either in the Financial Statements for year ended 31 December 2015.

Requirement:

In the context of FRS 102 Section 21 *Provisions and Contingencies;*

(a) Explain the term "provision".

2 Marks

(b) Explain how a contingent liability is different to a provision and how a contingent liability should be dealt with in the financial statements.

4Marks

(c) Explain how each of the events outlined in (i) to (iii) above should be dealt with in the Financial Statements of Eatwell Ltd for the year ended 31 December 2015.

6 Marks

(d) Draft any necessary journal entries to show how each of the events outlined in (i) to (iii) above should be shown in the Financial Statements of Eatwell Ltd for the year ended 31 December 2015. (Ignore insurance claims by the company).

6 Marks

Presentation 2 Marks

Total 20 Marks

QUESTION 5

A manufacturing company commissioned the building of a new factory. The costs associated were as follows:

	€/£
Site selection	30,000
Site purchase	1,000,000
Architect's fees	50,000
Engineer's fees	150,000
Legal fees	50,000
Construction costs	1,500,000
Testing & checking of machinery	250,000
Administration costs	500,000

The plant was available for use on 31st March 2014 and reached normal production levels by 31st October 2015.

Included in testing and checking of machinery costs was €/£50,000 in connection with a six-monthly diagnostic check of machinery.

Required;

(a) Calculate the cost of the factory to be included in Non –current assets in accordance with FRS 102 Section 17 *Property Plant and Equipment*.

4Marks

(b) Outline your reasons for the inclusion or exclusion of each of the above costs in/from the amount to be included in Non- current assets.

5 Marks

(c) Write a note on the requirements of FRS 102 with regard to each of the following;
(i) The capitalisation of finance costs associated with the construction of non- current assets.

3 Marks

(ii) The initial measurement of non- current assets.

3 Marks

(iii) The subsequent measurement of non current assets.

3 Marks

Presentation	**2 Marks**
Total	**20 Marks**

QUESTION 6

True Ltd has historically valued inventories using the FIFO method. In the year ended 31 March 2015, the directors have decided to change to the weighted average method of valuation in order to give a fairer presentation of the results and financial position of the company. The following information is available:

Inventory valuations	31/3/2015	31/3/2014	31/3/2013
FIFO method	€/£180,000	€/£160,000	€/£140,000
Weighted average method	€/£240,000	€/£195,000	€/£160,000

Requirement:
Write a report to the Directors of True Ltd detailing the following;

(a) an explanation of the terms, *"accounting policies", "accounting estimates"* and *"prior period errors".*

6 Marks

(b) the appropriate accounting treatment under FRS 102 section 10 *Accounting Policies, Estimates and Errors,* of changes in accounting policies, accounting estimates and prior period errors.

6 Marks

(c) the impact under FRS 102, of the change in inventory valuation, on the financial statements of True Ltd for the years ended 31 December 2013, 2014 and 2015 (Include the numerical effect of the changes for each of the three years involved).

6 Marks

Presentation 2 Marks
Total 20 Marks

●

2nd Year Examination: May 2016

Advanced Financial Accounting

Suggested Solutions and Examiner's Comments

Students please note: These are suggested solutions only; alternative answers may also be deemed to be correct and will be marked on their own merits.

Statistical Analysis – By Question						
Question No.	1	2	3	4	5	6
Average Mark (%)	58%	78%	67%	59%	49%	46%
Nos. Attempting	741	747	747	639	462	365

Statistical Analysis - Overall	
Pass Rate	80%
Average Mark	61%
Range of Marks	**Nos. of Students**
0-39	84
40-49	82
50-59	178
60-69	169
70 and over	265
Total No. Sitting Exam	**778**
Total Absent	42
Total Approved Absent	35
Total No. Applied for Exam	855

General Comments:

GENERAL COMMENTS ON THE PAPER AS A WHOLE
Overall another strong result from students this year. While there was some feed-back that examination of the practical application of FRS102 and interpretation of financial statements in questions 4-6 required more narrative than computational answers, the questions were reflective of the questions at the end of the relevant chapters in the manual and many students demonstrated both a strong understanding of the material examined and an ability to communicate that knowledge effectively.

Examiner's Comments on Question One

This question was generally well – answered.

Question 1
(a)
(i) Historical cost is a basis of measurement of the amounts at which assets and liabilities, income and expenses are included in the financial statements. The historical cost concept states that an asset should be valued at historical cost i.e. the cash or cash equivalent paid or the fair value of the consideration given on acquisition of the asset. Historical cost in the context of liabilities is the cash or cash equivalent received or the fair value of the non- cash assets received in exchange for the liability, at the time the liability was incurred. Historical cost in the context of income and expenses, is the cash or cash equivalent received or paid or the fair value of the consideration received or paid, at the time the related transaction took place.

Total Marks Allocated
4 Marks

(ii) The prudence concept provides that in conditions of uncertainty a degree of caution must be exercised when making judgements about estimates to ensure that income and assets are not overstated and expenses and liabilities are not understated. Where there is no uncertainty however, the prudence concept cannot be exercised as a means of understating assets or income or overstating liabilities and expenses. It does not permit bias.

Total Marks Allocated
4 Marks

(iii) The Going Concern concept is a concept or assumption underlying financial statement preparation of a business that the business in question can and will continue in business for the foreseeable future- at least 12 months. This facilitates application of the historical cost concept and other assumptions relevant to the preparation of financial statements for an ongoing business. If management were of the opinion that the business was not a going concern it would be more appropriate to prepare the financial statements on a break up basis – reflecting the value of the business assuming a fire-sale scenario.

Total Marks Allocated
4 Marks

(b)
The Accruals concept provides that income and expenditure is to be recognised in the financial statements of the year to which they relate rather than the year in which they are received or paid. This means that the financial statements of a particular year reflect the actual income and expenses of the year rather than the receipts and payments thereby providing users of the financial statements with a fair representation of actual performance for the year in question. For example an ESB bill due in December but paid in January must be provided for in the financial statements to 31 December. If it is not included in the December year-end financial statements the profit reported for the year would be overstated by the amount of the bill excluded. The greater the accrual excluded, the greater the effect on the financial statements.FRS102 provides that with the exception of the Statement of Cash Flow, financial statements should be prepared on an accruals basis.

Total Marks Allocated
4 Marks

(c)
If the presentation of financial statements was allowed to change on a regular basis or if the classification of elements within the financial statements was allowed to change without restriction,the comparability of financial statements would be significantly reduced. The capacity to manipulate results would increase and this would result in greater uncertainty as to the reliability of the information included in financial statements.

Total Marks Allocated
4 Marks **Total 20 Marks**

Examiner's Comments on Question Two

This question was generally well answered.

Question 2								**Total Marks Allocated**
Part	Solution							
								1.5 marks each
1	(b)							
2	(b)							
3	(c)	Dep. Yr 1	22500	Dep. Yr 2	15750	Dep.Yr.3	11025	
4	(d)							
5	(c)							
6	(a)	100000 +30000						
7	(b)							
8	(d)							
9	(a)							
10	(d)							
								Total 15 Marks

Examiner's Comments on Question Three

Many students scored very well in this question. Students who did not attempt parts (c) and (d) lost relatively easy marks.

				Total Marks Allocated
Question 3				
Statement of Comprehensive income for year to 31st March 2015				
	2015	2015	2014	
	€ '000	€ '000		
Revenue		1,432		**0.5**
Cost of sales (107+488-119)		476		**2**
Gross Profit		956		
Other income		30		**0.5**
		986		
Distribution costs - note 5	229			**2**
Admin expenses - note 5	615	844		**2**
		142		
Finance Costs		5		**0.5**
Profit before tax		137		
Taxation		30		**0.5**
Profit for the year		107		

			Total Marks Allocated
Statement of Financial Position as at 31st March 2015			
Assets			
Non-current assets			
PPE (see note 2)		1,023	**2**
		1,023	
Current Assets			
Inventories	119		**1**
Trade Receivables	158	277	**1**
		1,300	

Equity			
Share capital		200	**0.5**
Retained earnings		890	**1**
		1,090	
Liabilities			
Current liabilities			
Trade and other payables	117		**0.5**
Bank balance	63		**0.5**
Current tax payable	30	210	**0.5**
		1,300	

Statement of changes in equity for the year to 31st March 2015

	Share Cap	Other Reserves	Retained Earnings	Total Equity	**Total Marks Allocated**
	000	000	000	000	
Balance at 31st March 2014	200		803	1003	**1**
Total comprehensive income			107	107	**1**
Dividend paid			-20	-20	**1**
Balance at 31st March 2015	200		890	1090	**1**

Note 1 - Closing Inventory

Cost	160000	
Less reduction to NRV	41000	119000

Note 2: Depreciation

Non Current Assets	€ '000	€ '000	€ '000
Land at cost			720
Buildings at cost		250	
Depreciation to 31/3/14	90		
Depreciation for year (4%x250)	10	100	150
Equipment at cost		206	
Depreciation to 31/3/14	86		
Depreciation for year (40%x120)	48	134	72
Motor vehicles at cost (284-44)		240	
Depreciation to 31/3/14 (132-33)	99		
Depreciation for year (25%x240)	60	159	81
			1023

Disposal of vehicle

Cost	44
Less accumulated depreciation (3 year@25%)	33
Net book value at date of disposal	11
Proceeds received	10
Loss on disposal	
	1

Note 3: Bad debt & allowance for receivables

	183
Less bad debt write off	18
	165
Allowance for receivables	8
New allowance (165 @ 4%)	7
Decrease in allowance	1

Note 4: Finance costs
Loan interest reduce admin exp and show separately as finance cost

Note 5: Split of Expenses

	Dist	**Admin**
Per trial balance	101	186
Wages & salaries	69	207
Buildings depreciation	5	5
Equipment depreciation	12	36
Vehicles depreciation	42	18
Loss on disposal		1
Bank overdraft interest		-5
Director's fees		150
Bad debt - note 3		18
Reduction in allowance for rec.		-1
	229	615

(d) Accounting Policy Notes

Non Current assets and Depreciation.
Non current assets are stated in the financial statements at historical cost. Cost includes cost of purchases plus all costs incurred assets to the location and condition necessary for it to be capable of operating in the manner intended. Depreciation is calculated assets other than non-depreciable land, so as to write off the cost of those assets over their estimated useful lives at the following:

Building: 4% p.a. straight line
Equipment: 40% p.a. reducing balance
Vehicle: 25% p.a. straight line

Total 25 Marks

Examiner's Comments on Question Four

This question was based on chapter 10 in the text book with the question itself very similar to some of the practice question at the back of the chapter. Students lost marks where answers were vague and failed to capture the differences between a provision and a contingent liability.

Question 4

(a) A provision is a liability of uncertain timing or amount, e.g. a liability to pay for an electricity service received, where the bill has not yet been received but can be estimated based on past consumption and past bills. A liability is a present obligation as a result of a past event where it is probable that a transfer of economic benefits will be required and a reliable estimate of same can be made. Financial Statements must be adjusted to reflect provisions at the reporting year end date.

Total Marks Allocated
2 Marks

(b) A contingent liability does not meet all of the recognition criteria of a provision. A contingent liability is;
A possible but uncertain obligation, or
A present obligation that is not recognised because it is not probable that the entity will be required to transfer economic benefits or the amount of the obligation cannot be estimated reliably.
Contingent liabilities should not be recognised in financial statements, but they should be disclosed by way of a note to the financial statements unless the possibility of loss is remote.

Total Marks Allocated
4 Marks

(c)
(i) The provision included in the 2014 financial statements is no longer required as there is no longer a requirement to carry out the remedial works. Accordingly the provision should be reversed in the 2015 financial statements as the liability no longer exists. No adjustment is required to the 2014 financial statements.
(ii) The rent received should be posted to a rent received account and the company should reflect the total amount receivable (€1700) as other operating income in the 2015 Statement of Profit and Loss and other Comprehensive income.
(iii) As the award and associated legal costs are payable in respect of the claim in 2015, the 2015 financial statements should include an accrual for the damages of €37500 and the legal costs of €12,000.

Total Marks Allocated
2 Marks each

(d)

(i) Dr. Accruals - SOFP		€50,000	
Cr. Repairs – SOPL			€50,000

Being reversal of 2014 provision for remedial works. Liability no longer in existence.

(ii) Dr. Bank		€1,700	
Cr. Rental Income	SOPL		€1,700

Being rental income received on sub-letting of restaurant space.

(iii) Dr. Compensation claims	SOPL	€37,500	
Dr. Legal costs	SOPL	€12,000	
Cr. Accruals	SOFP		€49,500

Being accrual for compensation awards and associated legal costs.

Total Marks Allocated
2 Marks each **2 Marks for Presentation** **Total 20 Marks**

Examiner's Comments on Question Five

This question was drawn from chapter 6 of the text book the capitalisation of costs associated with the construction of non-current assets. Most students scored well in part (a) but lost easy marks by not following through in part (b) with an explanation of why they treated each cost in the manner they did.

Question 5

(a)

	Site Purchase	1000000
	Architect's fees	50000
	Engineer's fees	150000
	Legal fees	50000
	Construction costs	1500000
	Testing and checking of machinery	200000
Cost to be included in non current assets		2950000

Total Marks Allocated
0.5 Mark for the correct treatment of each item of cost.

(b)

Site selection costs are excluded because they were incurred in researching the most appropriate site before it was actually purchased. They are therefore not reflected in the completed factory. Site purchase cost is a directly attributable cost which is reflected in the completed asset. Architect's fees are a cost directly attributable to the design and construction of the building and therefore should be capitalised. Engineer's fees are a cost directly attributable to the design and construction of the building and therefore should be capitalised. Legal fees are capitalised on the basis that they are associated with the legalities associated with the purchase, design and construction contracts and hence are attributable to the completion of the asset. Construction costs are directly attributable to bringing the asset to its completed condition and hence should be capitalised. The element of the testing and checking cots that are incurred up to the point the asset was completed, fall to be capitalised. €50,000 of the costs were incurred after completion, on a six monthly check so only €200,000 falls to be capitalised. Administration costs cannot be directly attributable to bringing the asset to completion. They would have been incurred even if the asset was not constructed. Accordingly under IAS 16 these costs cannot be capitalised.

Total Marks Allocated
5 Marks in Total

(c)

(i)

Capitalisation of construction costs, in the context of non current assets refers to the inclusion of such costs as part of the cost of the asset in SOFP rather than treating the costs as expenses in the SOPL. The rationale for capitalising costs is that the costs are incurred in bringing the asset into working condition and will yield economic benefits for the company over the useful life of the asset. Where finance costs can be identified as being directly related to the construction of an asset ie the borrowings related specifically to the construction of the asset and the finance charges related to the construction phase, FRS102 allows the option to capitalise the finance charges but only up to the date the asset is capable of being used as intended.

(ii)
FRS 102 provides that a non - current asset should initially be recognised in the financial statements at cost. The cost of the asset should only be recognised to the extent that it can be measured reliably and it is probable that future economic benefits associated with the asset will flow to the business.

(iii)
FRS 102 provides that subsequent to initial recognition entities have a choice in terms of how non - current assets are carried in the Financial Statements. Entities can choose between the Cost model or the revaluation model. Using the cost model, assets are carried at cost less accumulated depreciation, while under the revaluation model, assets are carried at their fair value at the date of valuation less subsequent depreciation. If an entity chooses to adopt the revaluation model , it must do so for all assets in the same class, but not necessarily all classes of asset e.g. revalue all land and buildings but leave all equipment and motor vehicles at cost less depreciation.

Total Marks Allocated
3 Marks each
2 Marks for Presentation
Total 20 Marks

Examiner's Comments on Question Six

This question examined the students understanding of the difference between accounting policies, accounting estimated and prior period errors and the appropriate treatment of a change in accounting policy relating to the valuation of inventory. While many students were comfortable with the differences between accounting policies estimates and prior period errors, the application of a change in accounting policy to the valuation of inventory was poorly answered.

Question 6

Report

To: The Directors of True Ltd
From: ABD & Co
Re: Change in the method for valuation of inventory.
As the company has changed its method for valuing inventory from FIFO to weighted average there will be consequential effects on the financial statements of the company for the year ended 31 December 2015 and the 2014 comparative figures will also require adjustment. The purpose of this report is to explain the relevant accounting concepts and outline the appropriate accounting treatment under FRS 102 of the change in the method of inventory valuation.

Accounting Policies
Accounting policies are the specific principles, bases, conventions, rules and practices applied by an entity in preparing and presenting financial statements. Entities adopt accounting policies in relation to each major classification of asset and liability, revenue and expense. For example, an accounting policy is required in relation to the valuation of inventory. An entity might choose to value its inventory on a FIFO basis, if that represented the method most appropriate given the nature of the inventory. Typically FRS will either require a specific policy to be adopted in relation to a transaction or event or prescribe a choice of policies. If a choice is permitted such as in relation to the valuation of inventory as described above, management must use judgement to choose and apply the accounting policy which is most appropriate to the economic decision making needs of the users of the financial statements.

Accounting Estimates
Financial statements are not prepared under conditions of certainty. Instead significant uncertainties exist and these result in some figures in the financial statements being estimated. These are known as accounting estimates. An example would be making a judgement as to the estimated useful life of an asset for depreciation purposes.
Prior Period Errors
Prior period errors are omissions from and misstatements in an entity's financial statements for one or more prior periods resulting from mathematical mistakes, mistakes in applying accounting policies, oversights, misinterpretations of facts and fraud.

Total Marks Allocated
2 Marks each

(b)
Changes in accounting policies are reflected retrospectively in the Financial Statements. This means that all opening balances and prior year figures for the elements of the financial statements that are affected by the change in accounting policy must be restated as if the change in accounting policy had always been applied. The notes to the financial statements should give sufficient information on the nature of the change, the reasons for the change and the effect on the financial statements of the change.
Changes in estimates are required when the circumstances on which the estimate was based change, new information is received or the experience of management increases and refines the estimate. A change in estimate will affect the period in which the change occurred and if applicable future accounting periods. Changes in estimate are not applied retrospectively. If the effect on the financial statements is material in the current period, the nature and monetary effect of the change should be disclosed.
Material prior period errors must be corrected retrospectively in the first set of financial statements after the discovery of the error. The entity should restate the comparative figures in which the error occurred. If the error occurred before the earliest period presented, then the correction of the error will involve restating the opening balances of assets liabilities and equity that are affected by the error as if the error had never occurred. The notes to the financial statements should disclose the nature of the prior period error and the effect on the financial statements.

Total Marks Allocated
2 Marks each

(c)
No changes can be made to the published financial statements of TRUE Ltd for 2013 and 2014 as these financial statements have already been signed by the directors and approved at AGM. However the Financial Statements for 2015 should reflect the new accounting policy as should the comparative 2014 figures presented in the 2015 Financial Statements. The 2014 comparative figures should reflect not only the effect of the change in accounting policy for 2014 but also the effect on the opening balances coming forward from 2013.
The effect of the change in accounting policy for 2013 was to increase closing inventory and accordingly profit for the year by €20,000. Accordingly the opening balance on retained earnings coming forward in the 2014 comparative numbers will be increased by €20,000. The effect of the 2014 profit calculation will be €15,000. This is because while closing inventory increases by €35,000, opening inventory increases by €20,000 – resulting in a net effect on profit of €15000. Closing retained earnings for 2014 is therefore increased by €35,000 - €20,000 arising from the increase in the opening balance and €15,000 from the increase in the 2014 profit calculation. The adjustment to the 2015 profit as a result of the policy change is to increase profit by €25,000. Closing inventory increases by €60,000 but opening inventory also increases by €35,000 resulting in a net increase in profit of €25,000.
The overall effect of the policy change is to increase retained earnings at the end of 2015 by €60,000, split as follows, €20,000 in respect of 2013, €15,000 in respect of 2014 and €25,000 in respect of 2015(see Table below).

	2013	2014	2015
Increase in retained earnings coming forward	N/A	€20,000	€35,000
Increase in retained earnings for year	€20,000	€15,000	€25,000
Increase in closing retained earnings	€20,000	€35,000	€60,000

Adequate disclosures should be included in the 2015 financial statements explaining the change in accounting policy, the reasons for the change and the effect on the financial statements for 2015, and the comparative figures including the opening balances coming forward in 2014.
Signed

Total Marks Allocated
2 Marks each **2 Marks for Presentation** **Total 20 Marks**