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ACCA – Paper P2
Corporate Reporting
June 2015
Final Assessment

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Marking Report

Notice to Markers

1 When commenting about the script performance, please ensure on individual questions and on overall assessment your comments cover areas of examination technique including:

• Time management	• Handwriting	• Presentation and layout	• Use of English
• Points clearly and concisely made	• Relevance of answers to question	• Coverage and depth of answer	• Accuracy of calculations
• Calculations cross-referenced to workings	• All parts of the requirement attempted	• Length of answers equates to marks available	• Read the question carefully

2 For each question, please provide suitable constructive comments

Question Number	General Comments	Exam Technique Comments

ACCA FINAL ASSESSMENT

Corporate Reporting

June 2015

Paper P2 (INT/UK)

Time allowed

Reading time: **15 minutes**

Writing time: **3 hours**

This paper is divided into two sections

Section A This question is compulsory and MUST be answered

Section B TWO questions ONLY to be answered

Do not open this paper until instructed by the supervisor

This question paper must not be removed from the examination hall

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SECTION A

This question is compulsory and MUST be answered

1 Parsley is a public limited company which has investments in a number of other companies. These companies prepare their financial statements in accordance with International Financial Reporting Standards. The draft statements of profit or loss for Parsley and its investments for the year ended 30 April 20X4 are presented below:

	Parsley	*Sage*	*Saffron*
	$m	$m	FRm
Revenue	143	68	210
Cost of sales	(61)	(42)	(126)
Gross profit	82	26	84
Distribution costs	(10)	(6)	(14)
Administrative expenses	(23)	(10)	(29)
Operating profit	49	10	41
Investment income	1	2	–
Finance costs	(2)	(4)	(3)
Profit before taxation	48	8	38
Taxation	(11)	(2)	(9)
Profit for the period	37	6	29

The following notes are relevant to the preparation of the consolidated financial statements:

1 Parsley acquired 70% of Sage's one million $1 ordinary shares for $6m many years ago. At the acquisition date, the carrying value of Sage's net assets was $5m, and this was deemed to be the same as their fair value. The non-controlling interest was measured using the proportion of net assets method. Goodwill arising on the acquisition of Sage has never been impaired. On 31 October 20X3, Parsley sold 300,000 of its shares in Sage for $6.5m. The fair value of the interest retained was $9.5m. The retained earnings of Sage were $9m as at 30 April 20X3. The only entry posted in Parsley's individual financial statements is to record the cash received and to credit these proceeds to a suspense account.

2 On 1 May 20X3, Parsley purchased 60% of Saffron's one million FR1 ordinary shares for FR71m. The non-controlling interest at acquisition was valued at FR29m using the fair value method. At 1 May 20X3, the carrying value of Saffron's net assets was FR60m but the fair value was FR70m. The excess in fair value was due to an unrecognised brand with a remaining useful economic life of five years at the acquisition date.

3 At 30 April 20X4, it was determined that goodwill arising on the acquisition of Saffron was impaired by FR4m. Goodwill impairments are charged to administrative expenses.

4 On 28 February 20X4, Sage paid a dividend of $1m to its ordinary shareholders.

5 On 1 May 20X3, Parsley signed a lease to use an item of machinery. The useful economic life of the machine and the lease term were both five years. The fair value of the asset was $5m. Parsley must pay the lessor $1.3m annually in arrears. The payment for the year ended 30 April 20X4 was charged to cost of sales. No other accounting entries have been made in respect of the lease. The interest rate implicit in the lease is 9.5%.

6 On 1 June 20X3, Parsley commenced construction of a new head office and financed this out of its general borrowings. The construction was completed on 30 April 20X4 at a total cost of $10m (excluding interest on borrowings). Parsley has had the following loans outstanding for the whole financial year:

	$m
10% bank loan	14
8% loan notes	6

All interest for the year has been expensed to the statement of profit or loss.

7 On 1 November 20X3, Parsley granted 10,000 share options to each of its 100 managers. These options will vest on 31 October 20X5 if the managers are still employed. Five managers had left the company by 30 April 20X4 and it is expected that another five will leave by 31 October 20X5. The fair value of the share options was $3.10 on 1 November 20X3 and $5.15 on 30 April 20X4. No accounting entries have been posted in relation to this scheme.

8 The following exchange rates are relevant:

	FR: $1
1 May 20X3	5.0
30 April 20X4	4.0
Average for year ended 30 April 20X4	4.6

Required:

(a) Prepare the consolidated statement of profit or loss and other comprehensive income for the Parsley Group for the year ended 30 April 20X4. (35 marks)

Saffron operates in a country whose currency is the Franc (FR). Saffron makes 70% of its sales in Francs and 30% of its sales in dollars. Any dollar receipts are immediately converted into Francs. Saffron's line of business is different from the rest of the Parsley group, and it operates with considerable autonomy. It relies on finance in the form of local-currency bank loans, rather than intra-group finance.

Required:

(b) Apply the rules in IAS 21 *The Effects of Changes in Foreign Exchange Rates* to determine the functional currency of Saffron. (9 marks)

(c) Discuss the importance of ethics in the production of consolidated financial statements. (6 marks)

(Total: 50 marks)

SECTION B

TWO questions ONLY to be answered

2 Brick is a company that manufactures and sells mobile phones and mobile phone contracts. It prepares its financial statements under International Financial Reporting Standards and has a year end of 30 April 20X4.

(a) Brick launched a promotion during the year to attract new customers to its network. Under this promotion, customers sign a non-cancellable contract to subscribe to the Brick network for twelve months. The cost is $30 per month, payable at the end of each month. This price includes a new handset, network access, and 500 free minutes per month. The normal retail price of these elements is as follows:

	$
Handset	250
Network access (per month)	5
500 free minutes (per month)	10

Any free minutes that are unused at the end of the month cannot be carried forward to the next month. In total, 100,000 new customers signed up for this promotion. The contracts all began on 1 March 20X4. **(6 marks)**

(b) On 1 May 20X3, Brick bid $100m for a license to use the radio spectrum for the next generation of mobile phone services. These services will be offered to customers from 20X5.

Some investment analysts have argued in the press that Brick may have over-paid for this license. Market research has shown that most customers are extremely satisfied with current network speeds. It is therefore widely believed that this 'next generation' of mobile phone services will not gain mainstream popularity until 20X6 at the earliest. Under the terms of purchase, Brick is prohibited from selling the license to other mobile phone operators. **(5 marks)**

(c) Brick must pay a fee of 400,000 Dinar (DN) on 31 December 20X4. The directors of Brick have become increasingly concerned about exchange rate fluctuations and therefore, on 1 February 20X4, entered into a futures contract to buy DN400,000 for $200,000 on 31 December 20X4. This contract was designated as a cash flow hedge and all necessary documentation was completed.

Based on published exchange rates, DN400,000 would cost $228,000 on 30 April 20X4. The fair value of the futures contract at 30 April 20X4 had risen to $28,000. **(6 marks)**

(d) Brick needed to raise finance during the period and therefore entered into a sale and finance leaseback transaction. On 1 May 20X3, it sold property, plant and equipment with a carrying amount of $4.5m to the bank for proceeds of $6 million. This was then leased back on a 15 year term, with payments of $650,000 due annually in arrears. The rate of interest implicit in the lease is 7.1%. **(6 marks)**

Required:

Discuss how the above events should be accounted for in the financial statements of Brick for the year ended 30 April 20X4.

Note: the mark allocation is shown against each of the four events above.

Professional marks will be awarded in question 2 for the clarity and quality of the presentation and discussion. **(2 marks)**

(Total: 25 marks)

3 Golden Gate is a newly formed public limited company involved in property development. Their financial statements are prepared in accordance with International Financial Reporting Standards (IFRS). The following accounting issues have arisen in the year ended 30 June 20X4 and need to be resolved.

(a) Golden Gate owns investment properties, which are measured at fair value. The investment properties are held to earn rental income in the long term. Although the sales prices of similar properties are available, the directors believe that a fair value measurement based on their estimates of future rental income would more faithfully represent the value of the properties to Golden Gate. The directors are unsure as to whether this complies with the requirements of IFRS. **(5 marks)**

(b) During the year ended 30 June 20X4, a decision was made to relocate Golden Gate's key business functions in an attempt to reduce operating costs. The decision to relocate was communicated to those affected in June 20X4. Relocation expenses will not be paid until August 20X4 and are estimated at $3m. The directors of Golden Gate do not believe that the cost of $3m should be shown in the financial statements for the year ended 30 June 20X4 because no expenditure has been incurred. **(5 marks)**

(c) On 1 July 20X3, Golden Gate purchased a new item of property, plant and equipment for $10m. The asset had an expected useful life of 20 years. At 30 June 20X4, the asset was revalued to its fair value of $10.5m.

The directors of Golden Gate would like an explanation of the accounting treatment of this revaluation, including the deferred tax consequences. The asset is written off for tax purposes over 10 years. The tax rate at 30 June 20X4 was 20% but this was lowered to 18% on 15 July 20X4. **(7 marks)**

(d) On 1 February 20X4, Golden Gate purchased a property located overseas for CU2m. This property is to be sold in the ordinary course of business. On 30 June 20X4, it had an estimated net sales price of CU2.5m. This valuation was confirmed post year-end. There have been significant fluctuations in the currency markets. The following exchange rates are relevant:

Date	CU:$1
1 February 20X4	2.1
30 June 20X4	3.0

(6 marks)

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Required:

Discuss how the above events should be accounted for in the financial statements of Golden Gate for the year ended 30 June 20X4.

Note: the mark allocation is shown against each of the four events above.

Professional marks will be awarded in question 3 for the clarity and quality of the presentation and discussion. (2 marks)

(Total: 25 marks)

4 (a) The Conceptual Framework for Financial Reporting outlines the objectives of financial reporting and provides definitions of the elements. Entities sub-categorise and present these elements in accordance with IAS 1 *Presentation of Financial Statements.* IAS 1 states that an entity's financial statements must report information about their profit or loss as well as their other comprehensive income (OCI).

Required:

(i) Explain the objectives of financial reporting. (4 marks)

(ii) Outline, with examples, the requirements of IAS 1 with regards to the presentation of OCI. (6 marks)

(iii) Discuss possible criticisms of the current accounting treatment of OCI. (7 marks)

(b) The IASB has acknowledged that the Conceptual Framework lacks clear guidance about OCI. In an attempt to rectify this, a Discussion Paper on the Conceptual Framework was issued by the IASB in June 2013. This suggested new ways of conceptualising and recognising OCI. One of these approaches, the 'narrow approach', proposed that only two types of gains or losses should be recognised in OCI:

- Bridging items, which arise when the measurement of an item in the statement of financial position differs from its measurement in the statement of profit or loss.
- Mismatched remeasurements, which arise when there are linked assets and liabilities but only one item within the set is remeasured to current value.

An entity, Sleeper, is interested in the potential impact of these proposed amendments and wishes to know how the following transactions would be accounted for if the IASB enforced a 'narrow approach' to recognising OCI:

(i) A financial asset is measured at amortised cost in the statement of profit or loss but is held at fair value in the statement of financial position. The asset, which had a nominal value of \$10m and a coupon rate of interest of 4%, was purchased for its fair value of \$9m at the start of the financial year. The effective rate of interest is 8%. The fair value of the asset at the reporting date is \$11m.

(ii) Land, which has been classified as property, plant and equipment, is accounted for using the revaluation model. It was purchased for \$5m but its fair value at the reporting date is \$5.5m.

Required:

In relation to the above two transactions, explain how they would be accounted for if the IASB adopted a 'narrow approach' to the gains and losses that can be included in OCI. (6 marks)

Professional marks will be awarded in question 4 for the clarity and quality of the presentation and discussion. (2 marks)

(Total: 25 marks)

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