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ACCA FINAL ASSESSMENT

Corporate Reporting

December 2011

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

QUESTION 1

The following draft financial statements relate to the Baron Group.

Draft consolidated statement of comprehensive income for the year ended 30 November 20X1

	$m
Revenue	5,721
Cost of sales	(4,560)
Gross profit	1,161
Distribution costs	(309)
Administration expenses	(285)
	567
Income from interests in joint venture	75
Defence costs of takeover bid	(20)
Loss on disposal of tangible non-current assets	(7)
Loss on disposal of discontinued operations (Note (a))	(25)
Interest receivable	27
Interest payable	(19)
Profit before tax	598
Income tax expense (Note (e))	(191)
Profit for the year	407
Attributable to:	
Equity holders of the parent	332
Non-controlling interest	(75)
Profit for the year	407

Consolidated statement of changes in equity for the year ending 30 November 20X1

	$m
Opening capital and reserves	1,319
Profit for the year	332
Equity dividends paid	(130)
Deficit on revaluation of land and buildings	(30)
Deficit on revaluation of land and buildings in joint venture	(15)
Gain on revaluation of loan	28
Closing capital and reserves	1,504

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Draft consolidated statement of financial position as at 30 November 20X1

	20X1	*20X0*
	$m	$m
ASSETS		
Non-current assets		
Tangible assets (Note (f))	1,415	1,800
Intangible assets – goodwill (Note (b))	60	144
Investments (Notes (c) and (d))	600	–
	2,075	1,944
Current assets		
Inventories	720	680
Short term investments (Note (d))	152	44
Trade receivables (Note (g))	680	540
Cash	24	133
	1,576	1,397
Total assets	3,651	3,341
EQUITY AND LIABILITIES		
Equity share capital	440	440
Reserves	134	151
Retained earnings	930	728
Non-controlling interest	330	570
	1,834	1,889
Non-current liabilities		
Interest-bearing borrowings	186	214
Provisions – takeover bid defence costs	30	15
	216	229
Current liabilities		
Trade payables	1,300	973
Income tax	261	220
Interest payable	40	30
	1,601	1,223
Total equity and liabilities	3,651	3,341

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Notes:

The following information is relevant to the Baron Group.

(a) The group disposed of a major subsidiary Piece on 1 September 20X1. Baron held an 80% interest in the subsidiary at the date of disposal.

The group required the subsidiary Piece to prepare an interim statement of financial position at the date of the disposal. The consolidated carrying values of the net assets at the date of disposal are set out below in the summarised statement of financial position at 1 September 20X1.

	$m	$m
Tangible non-current assets		310
Current assets		
Inventories	60	
Trade receivables	50	
Cash	130	
		240
		550
Share capital		100
Retained earnings		320
		420
Trade payables	105	
Tax payable	25	
		130
		550

(b) The carrying amount relating to goodwill in the group accounts arising on the acquisition of Piece was $64 million at 1 December 20X0. The loss on sale of discontinued operations in the group accounts comprises:

		$m
Sale proceeds		375
CV of Piece at disposal:		
Net assets	420	
Goodwill	64	
	484	
Less: CV of NCI at disposal	(84)	
		(400)
Loss on disposal		(25)

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The consideration for the sale of Piece was 200 million equity shares of $1 in Meal, (the acquiring company) at a value of $300 million and $75 million in cash. During the year, the group recognised an impairment loss of $20m arising on other intangible assets.

(c) During the year, Baron had transferred several of its tangible assets to a newly created entity, Kevla which is owned jointly by three parties. The total investment at the date of transfer in the joint venture by Baron was $225 million at carrying value comprising $200 million in tangible non-current assets and $25 million in cash. The group has used equity accounting for the joint venture in Kevla. No dividends have been received from Kevla but the land and buildings transferred have been revalued at the year-end.

(d) The investments included under non-current assets comprised the joint venture in Kevla ($265 million), the shares in Meal ($300 million), and investments in corporate bonds ($35 million). The bonds had been purchased in November 20X1 and were deemed to be highly liquid, although Baron intended to hold them for the long term as their maturity date is 1 January 20X9.

The short term investments comprised the following items:

	20X1	*20X0*
	$m	$m
Government securities (repayable 1 April 20X2)	51	23
Cash on seven day deposit	101	21
	152	44

(e) The taxation charge in the statement of comprehensive income is made up of the following items:

	$m
Income tax	171
Tax attributable to joint venture	20
	191

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(f) The movement on tangible non-current assets of the Baron Group during the year was as follows:

	$m
Cost or valuation 1 December 20X0	2,100
Additions	380
Revaluation	(30)
Disposals and transfers	(680)
At 30 November 20X1	1,770
Depreciation	
1 December 20X0	300
Charged during year	150
Disposals and transfers	(95)
At 30 November 20X1	355
Carrying value at 30 November 20X1	1,415
Carrying value at 1 December 20X0	1,800

(g) Interest receivable included in trade receivables was $5 million at 30 November 20X1 ($4 million at 30 November 20X0).

Required:

(a) Prepare a consolidated cash flow statement for the Baron Group for the year ended 30 November 20X1, including the note relating to the disposal of Piece, in accordance with the requirements of IAS 7 *Cash Flow Statements*. (35 marks)

You are required to use the 'indirect method' to produce the cash flow statement. Other notes to the cash flow statement are not required.

The directors of Baron are considering raising finance to expand the group. One option they are reviewing is to sell one of their factories to Indigo, a subsidiary of Emerald Bank for $10 million. The factory has a carrying value of $8.5 million. Indigo will be financed by a loan of $10 million from Emerald Bank. Baron will be paid a fee from Indigo to continue to operate the factory. The fee amounts to the balance of any profit remaining after interest has been paid on the loan outstanding to Emerald Bank. If the factory makes operating losses, Baron will be charged a fee that covers the operating losses and the interest payable.

Required:

(b) Evaluate the substance of this transaction and determine the accounting treatment.

(9 marks)

(c) Discuss briefly the importance of ethical behaviour in the preparation of financial statements and whether this arrangement could constitute unethical practice by the directors of Baron. (6 marks)

(Total: 50 marks)

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SECTION B

TWO questions ONLY to be answered

QUESTION 2

On the first day of the accounting period Cold enters into a three-year lease for an asset that has a cash price of $20,000. The asset has an expected useful life of 10 years. Cold has an option to extend the lease after three years for a further two years on normal commercial terms. Under the terms of the lease the rentals payable in the first year are $4,000 and thereafter $2,000 per year. In the draft accounts an expense has been charged with the cash paid and no asset or liability has been recognised.

In addition, given a tax rate of 30%, determine the deferred tax implications of the correct accounting treatment if tax relief will only be granted on the cash payments.

Required:

(i) Explain how this lease should be accounted for. (4 marks)

(ii) Show the extracts from the accounts. (2 marks)

(iii) Explain the deferred tax implications of the correct accounting treatment. (3 marks)

(iv) Show the deferred tax extract from the accounts. (1 mark)

On the first day of the accounting period ago Cold purchased a $5,000 6% fixed rate bond for $4,670 with five year remaining to maturity. The effective rate of interest for the asset is 7.65%. The investment was designated to be measured at amortised cost. In the draft accounts the interest received of $300 has been recognised as an expense.

Required:

(i) Explain how this financial instrument is to be accounted for. (5 marks)

(ii) Show the extract from the accounts. (3 marks)

Two years prior to the current year end Cold offered an incentive to staff that they would in three years time be paid a cash bonus of $2,000 each for every $1 that the company's share price rose. Whilst 50 staff where granted these share appreciation rights, 10 left during the current year. At the end of year one the share price had risen by $2 but at the current year-end it was $3 higher than it was at the date the share appreciation rights were originally granted.

Required:

(i) Explain how the share appreciation rights (cash settled share based payments) should be accounted for. (4 marks)

(ii) Show the extracts from the accounts. (3 marks)

(Total: 25 marks)

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QUESTION 3

The managing partner has asked you, on behalf of a shareholder, to prepare a report on the financial and business position of Hunter, a listed entity. There has been adverse press comment on the 'aggressive management of earnings' by Hunter and criticism of the management. Information about Hunter has been gathered by the partner and this is set out below:

Business and financial environment

Hunter provides internet-based electronic hosting, delivery and marketing services. Hunter was formed in 20X0 with the Board promising to take the entity into the top 10% of listed entities within five years. Management are highly motivated and are compensated in part via share/stock options. Management work in a pressurised environment.

Hunter makes use of different corporate entities in order to finance its business. Hunter has borrowed $40 million from twenty different finance houses which are owned by a bank, which itself owns twenty per cent of the shares of Hunter. Hunter has deposited $35 million with the finance houses with the net balance being shown as a current liability. The management of Hunter say that the finance houses are not under their control and that because each amount borrowed is individually immaterial there is no need to disclose the relationship in the financial statements. Additionally, it appears that in previous years a common practice was for Hunter to invoice the same finance houses in the final week of the financial year for services and reverse the invoices once Hunter had filed its financial statements.

Financial statement information extracted from the published accounts for the years ended 31 January 20X4 and 20X3

(i) **Extracts from statement of financial condition**

	20X4	*20X3*
	$m	$m
Non-current assets at valuation:		
Property	10	8
Plant and equipment	40	30
Intangibles	20	12
Current assets	230	240
Current liabilities	180	140
Share capital – $1 equity shares	30	30
Reserves – Revaluation reserve	30	20
Retained earnings	10	60
Non-current liabilities	50	40
Extracts from statement of comprehensive income		
Revenue	160	200
Profit before interest, tax, depreciation and amortisation	30	95
Profit/(loss) before tax	(10)	40
Extraordinary loss	(20)	(5)
Other information		
Number of employees	150	250
Number of days after year-end to publication of financial statements	65	25

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(ii) The non-current assets have been revalued by one of the directors of Hunter who holds no recognised professional qualification and has used estimated realisable value as the basis of valuation. The plant and equipment is of a highly specialised nature and is constructed by Hunter itself and is mainly computer hardware. The intangible assets are the data purchase and data capture costs of internally developed databases and are capitalised as development expenditure and written off over four years.

(iii) In the year to 31 January 20X3, a six year bond was issued by Hunter with a par value of $40 million for $42 million. The excess over par value was recognised in profit or loss. In the year to 31 January 20X4, a further six year bond with a par value of $10 million was issued for $11 million and accounted for in the same manner. The investors may request redemption after three years or if the working capital ratio falls below 1.3. The bonds bear interest at 5% per annum and are redeemable at par.

(iv) Revenue represents the invoiced amount of goods sold and services provided and work undertaken during the year on contracts after the deduction of trade discounts and sales related taxes.

(v) Hunter has published pro-forma financial statements for the four months to 31 May 20X4 showing profit before tax to be $20 million, long-term liabilities reduced to $10 million, and the working capital ratio as being 1.5.

(vi) The extraordinary losses are the estimated impact of terrorist attacks in the USA upon the business of Hunter during the period. Following revisions to IAS 1, no items in future are to be presented as extraordinary items.

Required:

Prepare a report for the managing partner on the business and financial position of Hunter, setting out the implications of the financial and other information outlined above.

(25 marks)

QUESTION 4

Why might there be a need for a different financial reporting regime for small and medium-sized entities (SME) and explain the recent developments to produce an IFRS for SMEs. You should make reference to benefits expected to accrue from adoption of IFRS for SME.

(Total: 25 marks)

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