London
School of Business
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ACCA

Paper P2 (International)

Corporate Reporting

Tuition Mock Examination

June 2012

Answer Guide

Health Warning!	
How to pass	Attempt the mock examination under exam conditions BEFORE looking at these suggested answers. Then constructively compare your answer, identifying the points you made well and identifying those not so well made. If you got basics wrong then re-revise by re-writing them out until you get them correct.
How to fail	Simply read or audit the answers congratulating yourself that you would have answered the questions as per the suggested answers.

Question 1

Tutorial help and key points

Note that this question is based upon Xenon, the full question on foreign subsidiaries which is covered in the chapter on foreign currency translation. If you struggle with any of this question Xtreme, especially the tricky inter-company trading in (4) and (5), then you should go back to that question Xenon, which is itself based on past exam questions.

Marking Guide

		Marks
(a)		30
(b)		5
(c)	1 mark per point (any reasonable point will score)	6
(d)	1 mark per point (any reasonable point will score)	9

Note: please see further in the body of the answer guide for more hints on where marks are awarded.

Total marks	**50**

(a)

I/S and B/S

Net assets	**Acq**	**B/S**
SC	500	500
SP	900	900
RE	20,000	23,600
FVA (3) (calculated as a balancing figure then depreciation charged)	8,600	7,740
Forex (4) (80 x 14 – 80 x 15)		(80)
Forex (5) (100 x 13 – 100 x 18)		(500)
Given	30,000	32,160

FVA depreciation is 860 (1/10yearsx 8,600).

Goodwill

FV of consideration (2,000)(13)	26,000
FV of NCI (30,000)(30%)	9,000
FV of NA	(30,000)
	5,000

Group B/S

NCA		
Goodwill (5,000/18)		278
Tangible (11,500 + (34,000 + 7,740)/18)		13,818
CA (5,000 + 22,000/18 – 12 PUP – 100 CA)		6,110
CL (2,000 + (10,000 + 80 Forex)/18)		(2,560)
NCL (5,300 + (21,000 – 1,300 Loan)/18)		(6,394)
		11,252
		(12 marks)
SC		1,000
SP		500
RE (below)	**(0 marks because marks in part b)**	9,216
MI [9,000 + (32,160 - 30,000)30%]/18	**(2 marks)**	536
		11,252

Note that the equity presentation of the b/s above is perfectly acceptable under IAS1, as is the more usual assets and liabilities presentation.

Note that the pup is 80(20%)3/4.

Group reserves direct

Parent (9,700 - 12 PUP)			9,688
Sub (32,160 - 30,000)(70%)/18			84
Forex on invest	26,000/18 =	1,444	
	26,000/13 =	(2,000)	
		556	(556)
RE			9,216

(0 marks because marks in part b)

Group I/S

	Parent	Sub	Rate	Sub	Adj	Group
Revenue	10,000	28,000	17	1,647	(80)	11,567
Cost of sales	(6,500)	(14,000)	17	(823)	80	(7,306)
	PUP(12)	FVA(860)	17	(51)		
Gross profit						
Operating expenses	(900)	(7,000)	17	(412)		(1,330)
		IMP (300)	17	(18)		
Operating profit						
Dividend Income	60				(4)	56
Interest expense	(700)	(3,000)	17	(176)		(876)
Interest income	200	1,000	17	59		259
Forex		(80)	17	(5)		(34)
		(500)	17	(29)		
Profit before tax						
Tax	(860)	(1,000)	17	(59)		(919)
Profit after tax		2,260	17	133		
MI				30%		(40)
PAM						1,377

(11 marks)

Note that the dividend income is based on the internal dividend from G of $4m (100 x 70%/18) being removed from the parent dividend income of $60m.

(b)

Group reserve movement

Opening			9,000
PAM			1,377
Dividends			(600)
Forex	2,260/18 =	126	
	2,260/17 =	(133)	
		(7) (70%)	(5)
Forex	30,000/18 =	1,667	
	30,000/13 =	(2,307)	
		(641) (70%)	(449)
Forex	5,000/18 =	278	
	5,000/13 =	(384)	
		(107)	(107)
Closing			9,216

Note that the forex on the goodwill does not need to be multiplied by 70% because it is all ours already. The goodwill of Kr5,000m is partial goodwill and so excludes any NCI ownership.

(c)

Presentational currency

This is simply the currency in which the FS are presented to the shareholders. It is determined by demand, so if the shareholders demand FS in $, that is what they get.

Presentational currency Ginormous

The parent Xtreme work in $ and want the Ginormous FS for consolidation. So of course they will demand FS in $ from Ginormous. So Ginormous must translate their FS.

Second presentational currency Ginormous

However, give that there is a 30% NCI, it seems likely that Ginormous will also present locally in Kram.

Functional currency

This is simply the currency in which the entity functions. It is determined by the currency dominating buying selling financing and especially competitive behaviour.

Functional currency Ginormous

The transactions in (4) and (5) are relatively minor. Everything else that Ginormous does is in Kram. So Ginormous functions in Kram.

Effect

The effect of this is that Ginormous must first produce its FS in Kram and then translate those FS to $ for the parent, this is required but IAS21, but is exactly as happened quite naturally without any great thought.

(d)

Presentation

The large forex loss on retranslation of the subsidiary calculated in part (b) above is presented not only in the reserve movement note, but more prominently in the OCI.

OCI (Other comprehensive income statement)

This is tagged on to the end of the income statement and therefore usually appears on page one of the FS.

Prominence

Therefore this forex loss is highly prominent and may make readers of the FS negative towards Ginormous and the Xtreme directors who masterminded the purchase.

Other financial data

It is true that the other financial data, such as the enormous profit turned by Ginormous, is lost during the process of consolidation. Other information, like the basis of the acquisition, is not part of the FS at all.

Segmental reporting

Xtreme directors can communicate some of the good news regarding Ginormous by using segmental reporting. X and G operate in different countries, so the groups can split the results out for shareholders in the segmental note.

Channels

The above is a good start, but to really communicate all that they wish to communicate, group directors should consider other channels.

Website

The most obvious channel for communication is the company website. Group directors should dedicate a whole section of their website to the Ginormous acquisition, its purpose and its success.

Press conference

They should also call a press conference to announce the acquisition and explain its reasoning, although if they have not done so already, it may be a bit late now.

Management commentary

But perhaps most obvious is the management commentary. This is the supplementary report that is presented to shareholders alongside the FS that is designed to translate those FS into clear words and pictures.

Section

A whole section of the commentary should be dedicated to the Ginormous acquisition covering the acquisition reasoning, the synergies, the profitability, the products, the markets and many other issues.

Question 2

Tutorial help and key points

This question really crunches through all the permutations under the new(ish) IFRS3 (revised 2008). If you struggle with it all, then you are highly recommended to go back to the Basic Groups chapter in the class notes and rework all the examples under the section on Changes in Ownership.

Marking Guide

The marking scheme is given within the body of the answer.

(a)

Goodwill

	%	**Working**	**Sub**
FV of consideration	45%		80
FV of previous	15%		25
FV of NCI	40%		65
FV of NA			(75)
Goodwill			95

(1 mark for each above)

By the way, the parent records a gain on the previous equity of 15% of $4m in the P/L (I/S).

COMMENTARY ON TRANSFERS

The following represents a commentary on transfers. It is designed to help (hopefully) with the tricky illogical and counter-intuitive subject of transfers. But is does not form part of the answer.

When controlling interest ownership goes up following acquisition, there is no further acquisition because the parent already has control. Instead a transfer to the CI from the NCI is recorded (Green and Blue)

The same principle is used when parental ownership decreases but control is retained (Purple and Cyan).

PRESENTATION

A real B/S has a complex equity presentation which is compressed at P2.

Real B/S			**P2 B/S**
SC	Share capital		SC
SP	Share premium		SP
RR	Revaluation reserve	)	
IRR	Investment revaluation reserve	)	
SBBR	Share based payment reserve	)	
FR	Forex reserve	)	OCE (other components of equity)
CFHR	Cash flow hedge reserve	)	
RE	Retained earnings		RE
NCI	Non-controlling interest		NCI

So all those middle reserve are compressed into OCE. So transfers are between NCI and OCE.

CONCEPT UNDERLYING TRANSFERS

The examiner is inconsistent in his application of the above. He does one transfer one way and the other another way.

CI OWNERSHIP UP

When the CI ownership increases, we look at this very definitely as the NCI transferring to CI. So they are deemed to have transferred a proportion of their ownership.

Example (1)

CI 65% $\rightarrow$ CI 75%

NCI transfer = 10%/35% of NCI

Example (2)

CI 75% $\rightarrow$ CI 80%

NCI transfer = 5%/25% of NCI

Example (3)

CI 80% $\rightarrow$ CI 90%

NCI transfer = 10%/20% of NCI

CI OWNERSHIP DOWN

However, on the way down the examiner ignores who is transferring to who and applies a % to the whole sub.

Example (4)

CI 95% $\rightarrow$ CI 80%

CI transfer = 15% of the sub

Example (5)

CI 80% $\rightarrow$ CI 70%

CI transfer = 10% of the sub

Example (6)

CI 70% → CI 53%

CI transfer = 17% of the sub

Here ends the commentary (at least until it restarts with the answer to (b) below).

(b)

Answer commentary

We do not care how big the sub is at the point of transfer. All we care about is the size of the NCI at the point of transfer.

Answer

NCI before transfer [acq 30 + growth 110 (25%)]	32.5
Transfer (5%/25%) (32.5)	(6.5)
NCI after transfer	26.0

(2 marks)

Dr	NCI		6.5	
	Cr	OCE		6.5
Dr	OCE		9.0	
	Cr	Bank		9.0

So there is a decrease in parental equity of $2.5m.

(2 marks)

(c)

NCI

NCI before transfer [acq 27 + growth 16 (20%)]	30.2
Transfer (10%/20%)	(15.1)
NCI after transfer	15.1

(2 marks)

Dr	NCI		15.1	
	Cr	OCE		15.1
Dr	OCE		15.0	
	Cr	Bank		15.0

So there is an increase in parental equity of $0.1m.

(2 marks)

(d)

Answer commentary

The flow of this answer is completely different to that in example 2. This is because of the inconsistency. We now identify the size of the whole sub and transfer 10%.

Answer

NA

	Acq	Y/e
NA	80	96

Growth = 16

Goodwill

	%	Working	Sub
FV of consideration	80%		110
FV of NCI	20%		27
FV of NA			(80)
Goodwill			57

Transfer

Sub [NA 96 + GW 57]	153.0
	x 10%
Transfer	15.3

(2 marks)

Dr	OCE		15.3	
	Cr	NCI		15.3
Dr	Bank		15.0	
	Cr	OCE		15.0

So there is a *decrease* in parental equity of $0.3m.

(2 marks)

(e)

NA

	Acq	Y/e
NA	180	150

Growth = 30

Goodwill

	%	Working	Sub
FV of consideration	65%		200
FV of NCI	35%		150
FV of NA			(180)
Goodwill			170

Transfer

Sub [NA 150 + GW 170]	320
	x 5%
Transfer	16

(2 marks)

Dr	OCE		16	
	Cr	NCI		16
Dr	Bank		20	
	Cr	OCE		20

So there is an *increase* in parental equity of $0.3m.

(2 marks)

(f)

Answer commentary

When we lose control of the sub, we lose control of the sub entirely. So we are deemed to have sole the entire sub. So we deemed to have sold the 45% and instantly bought it back.

Answer

NA

	Acq	**Y/e**
NA	80	100

Growth = 20

Goodwill

	%	**Working**	**Sub**
FV of consideration	60%		190
FV of NCI	40%		110
FV of NA			(80)
Goodwill			220

(1 mark)

Disposal

Actual sale proceeds	15%	50
Deemed sale proceeds	45%	145
NCI [acq 110 + growth 20 (40%)]	40%	118
NA		(100)
GW		(220)
Profit		(7)

(4 marks)

Presentation

This is usually presented as super-exceptional:

Operating	x
Disposal of sub	(7)
Financing	x
Tax	x

Question 3

Tutorial help and key points

This question is based loosely on a past exam question called Seejoy. That too was the financial reporting of a football club. If you find the following useful, you may want to check out Seejoy.

Marking Guide

1 mark per point as usual.

(a)

Star

Intangible

An intangible must be capitalised if it is purchased (either separately or as part of a sub).

Star

The star was clearly purchased, so the value at purchase is measureable, so the star must be capitalised at $20m at purchase.

Revaluation

Intangibles can only be revalued if they are generics freely bought and sold on an active liquid market. Essentially this never happens. It only applies to really strange intangibles like marketed carbon footprint quotas.

Revaluation of football players

Football players are far from generic, every one of them is different. Further the market is nothing like an active stock market. A few hundred player change hands every year on the football player market. Thousands upon thousands of shares change hands every hour on a stock exchange.

Depreciation

So the star cannot be revalued. In fact he must be depreciated to recognise the cost of use.

Held for sale

The asset can only be moved into current assets if the asset is held for sale.

Available

For this to apply the asset must be available for immediate sale at the year end. Hobble do intend to sell the player, but at the accounting year end the intent is to play him until the end of the season in two months

NCA

Therefore the asset is not held for sale and must remain in non-current assets.

Carrying value

This would be as follows:

Cost	20
Depreciation (1/5)	(4)
Closing	16

(b)

Bond

Split

The bond is considered part debt and part equity and must be split into its component parts at the year start.

Discounted cash flow

The DCF on the expected cash works out as follows:

Year	Cash	Factor (8%)	PV
1	1	0.926	0.926
2	1	0.857	0.857
3	1	0.794	0.794
4	101	0.735	74.235
Debt			77

Equity

So the equity element is calculated as a balancing figure:

Debt	77
Equity	23
Cash	100

Unwinding

The debt then unwinds over the current year:

Year	Opening	Interest (8%)	Instalment	Closing
1	77	6	(1)	82

B/S

So in the position statement will be a non-current liability of $82m and an equity reserve of $23m.

I/S

Whilst in the performance statement a finance cost of $6m is recognised.

CFS

Finally in the cash flow statement there will be an inflow of $100m from the lenders and an outflow of $1m for the nominal interest.

Disclosure

The security is purely a matter of disclosure and would go in the notes.

(c)

Stadium

Sale Proceeds

Of course, the reason the sale proceeds look foolishly low compared to the fair value ($30m to $40m) is because the sale proceeds are not sale proceeds. They are in fact the proceeds from a loan.

Risks

Hobble continue to face the risks related to the stadium as indicated by the obligation to cover maintenance.

Rewards

Hobble continue to possess the reward of using the stadium even after the contract is signed.

Conclusion

So the stadium is still ours and is therefore not derecognised.

Depreciation

Clearly the stadium is in use throughout the year and therefore depreciation is required.

Opening	24
Depreciation	(2)
Closing	22

Loan

The cash received is in fact repaid at the end of the life of the stadium and therefore represents a simple loan. The double entry for this cash flow is as follows:

Dr	Cash	30
Cr	Loan	30

Interest

And the further annual payment is simple interest:

Dr	Interest expense (p/l)	2.4
Cr	Cash	2.4

But note this payment will not happen until next year and so is not part of the current year FS.

Movement

By the way the movement on the loan is as follows:

Year	**Opening**	**Interest (8%)**	**Instalment**	**Closing**
Next Year	30	2.4	(2.4)	30

Security

Because the legal title has been transferred to the bank, the bank now possess solid security for their lending. This security would be described in the notes along with the other details about this new loan.

Clashing security

But there is a problem that Hobble seem to have missed. The stadium was security for the bond (b) and now legal title has transferred to the bank (c). It seems highly likely that the terms of either one or both of the loans have been breached. It is quite possible that both loans are due immediately because of the breach. So maybe they need to go into current liabilities rather than the more natural non-current liabilities.

IAS17

There is a detail in IAS17 that really makes no sense and therefore I have ignored it. It is there, however. It says effectively that a sale and leaseback of the nature described above triggers a compulsory revaluation of the related property. The above is a sale a repurchase and not a sale and leaseback, but as the two are very similar, it could be argued that a compulsory revaluation is required. I am not going to argue this as I believe the compulsory revaluation rules in IAS17 clash with the requirement for consistency of carrying model in IAS16.

Question 4

Tutorial help and key points

Marking Guide

1 mark per point as usual.

(a)

Americans

It is widely accepted that the biggest challenge to convergence is the Americans. Once the USA adopts IFRSs the rest of the world will follow.

Road map

In fact the IASB and FASB have a detailed plan to converge called the road map.

Obama

The good news for convergence is that after a period of settling in the new administration has confirmed its commitment to convergence.

EU

The European Union is the other big block that must accept IFRS for convergence to work.

EU IFRS

Recently the EU became anti-convergent when it set up the principle to the EU IFRS. Fortunately it has agreed to abandon this idea.

English

Another big problem that the IASB have is that the IFRS are in English and this is a highly politicised language.

Translation

Even translation as a solution to the above creates its own problems, especially in the area of mistranslation.

Cost

Another problem is that first time adoption is expensive for companies and they might be resistant to this expense in a recession.

Education

Yet another problem is that each country that adopts IFRS has a lack of experience in IFRS for the first few years.

Resistance

There might be a general feeling of resistance to adopting IFRS because smaller countries might feel dominated by the larger economies.

National GAAP

There might be a feeling in some countries that their existent national GAAP is better than IFRS.

Culture

And related to this, those countries with a national GAAP that is prescriptive might struggle with the move to conceptual IFRS.

SMEs

Many countries have refused IFRS until an IFRS for SMEs is issued. This has happened now.

Quality of IFRS

Another problem for the IASB is that some of their IFRS are of a low quality.

Example: IAS39

For example we have the nonsense about the recycling of AFS gains.

Inconsistency in IFRS

There are also lots of choices in IFRS which undermine consistency.

Example: IFRS3

For example there is a horrendous recent inconsistency introduced by IFRS3 in the form of a choice between full or partial goodwill.

Standard setters

Another tricky problem is that the IASB have to convince national ASB that their job is redundant.

Time

The final problem is time. Any big change does and probably should take time.

Conclusion

Despite these challenges it does seem likely that the IASB will get their way.

(Maximum 10 marks)

(b)

Goodwill

The biggest change is to goodwill. A choice of policy is available.

NCI

The choice of policy depends on how you value the NCI:

(i) *Full* – NCI is valued at fair value

(ii) *Partial* – NCI is valued at fair value of NA.

Example

Say consideration for 80% cost $1,000m, the FV of NCI was $200m and FV of NA was $720m. Goodwill is calculated as follows:

Goodwill	**%**	**Working**	**Full**	**%**	**Working**	**Partial**
FV of consideration	80%		1,000	80%		1,000
FV of NCI	20%		200	20%	20(720)	144
FV of NA			(720)			(720)
Goodwill			480			424

(Maximum of 6 marks for discussion of goodwill)

Other points

(1) *NCI*

Minority interest changes to non-controlling interest.

(2) *Acquisition*

There is one point of acquisition; the point of attaining control.

(3) *Disposal*

There is one point of disposal; the point of losing control.

(4) *Transfers*

So changes in ownership whilst we retain control are called transfers.

(4 marks)