Professional Level – Essentials Module

Corporate Reporting (Irish)

March/June 2016 – Sample Questions

Time allowed
Reading and planning: 15 minutes
Writing: 3 hours

This question paper is divided into two sections:

Section A – This ONE question is compulsory and MUST be attempted

Section B – TWO questions ONLY to be attempted

Do NOT open this question paper until instructed by the supervisor.

During reading and planning time only the question paper may be annotated. You must NOT write in your answer booklet until instructed by the supervisor.

This question paper must not be removed from the examination hall.

Paper P2 (IRL)

Think Ahead ACCA

The Association of Chartered Certified Accountants

Section A – THIS ONE question is compulsory and MUST be attempted

1 The following information relates to the financial statements of the Weston Group:

Weston Group: Statement of financial position as at 31 January

	2016	2015
	$m	$m
Assets		
Non-current assets		
Property, plant and equipment	352	386
Goodwill	4	19
Other intangible assets	37	27
Investment in associate	102	
	495	432
Current assets		
Inventories	108	165
Trade and other receivables	106	104
Financial assets at amortised cost	19	
Cash and cash equivalents	20	43
	253	312
Total assets	748	744
Equity and liabilities		
Share capital	100	100
Retained earnings	377	270
Other components of equity	24	21
	501	391
Non-controlling interest	64	85
Total equity	565	476
Non-current liabilities		
Long term borrowings	26	48
Retirement benefit liability	60	72
Net deferred tax liability	14	15
Total non-current liabilities	100	135
Current liabilities		
Trade and other payables	36	41
Current tax payable	47	92
Total current liabilities	83	133
Total liabilities	183	268
	748	744

Weston Group: Statement of profit or loss and other comprehensive income for the year ended 31 January 2016

	$m
Continuing operations	
Revenue	1,102
Cost of sales	(818)
Gross profit	284
Other income	14
Distribution costs	(45)
Administrative expenses	(63)
Finance costs	(23)
Share of profit of associate	16
Profit before tax	183
Income tax expense	(40)
Profit for the year continuing operations	143
Discontinued operations	
Loss for the year from discontinued operations (see note (ii))	(25)
Profit for the year	118
Other comprehensive income for the year (after tax) which will not be reclassified to profit or loss in future years	
Remeasurement gains on defined benefit plan	3
Total comprehensive income for the year	121
Profit/loss attributable to:	
Owners of the parent	107
Non-controlling interests	11
	118
Total comprehensive income for the year attributable to:	
Owners of the parent	110
Non-controlling interests	11
	121

Notes:

(i) On 31 July 2015, Weston disposed of their entire 80% equity holding in Northern for cash. The shares had been acquired on 31 July 2011 for a consideration of $132 million when the fair value of the net assets was $124 million. This included a fair value uplift of $16 million in relation to plant with a remaining useful life of eight years. Deferred tax at 25% on the fair value adjustment was also correctly provided for in the group accounts and is included within the fair value of the net assets. The fair value of the non-controlling interest at acquisition was $28 million. Goodwill, calculated under the full fair value method, was tested annually for impairment. At 31 January 2015, goodwill relating to Northern had been impaired by 75%. A goodwill impairment charge has been included within administration expenses for the current year but does not relate to Northern.

The carrying values in the individual accounts of Northern at disposal are listed below. The fair value adjustment and subsequent deferred tax were not incorporated into the individual accounts of Northern.

	Carrying values $m
Property, plant and equipment	80
Inventory	38
Trade receivables	23
Trade and other payables	(10)
Deferred tax liability	(6)
Bank overdraft	(2)

(ii) The loss for the period from discontinued operations in the consolidated statement of profit or loss and other comprehensive income relates to Northern and can be analysed as follows:

	$m
Profit before tax	6
Income tax expense	(2)
Loss on disposal	(29)
	(25)

(iii) Weston purchased a 40% interest in an associate for cash on 1 February 2015. The associate paid a dividend of $10 million in the year ended 31 January 2016.

(iv) The retirement benefit liability relates to Weston as other companies in the group operate defined contribution schemes. The latest actuarial valuation is as follows:

	$m
Net obligation at 1 February 2015	72
Service cost component	11
Contributions to scheme	(19)
Remeasurements – actuarial gains	(4)
Net obligation at 31 January 2016	60

The benefits paid in the period by the trustees of the scheme were $7 million. Weston operates in a country which only allows tax relief when contributions are paid into the scheme. The tax base was therefore zero at 31 January 2015 and 31 January 2016. The tax rate paid by Weston is 25%. The defined benefit expense is included within administrative expenses.

(v) On 1 February 2015, Weston commenced development expenditure on product Q. Product Q is expected to be launched during 2017. $7 million amortisation on other intangible assets is included within cost of sales.

(vi) There were no disposals of property, plant and equipment during the year except on the sale of Northern. Depreciation for the year was $20m and is included within the cost of sales.

(vii) The financial asset at amortised cost is a $20 million two-year loan which Weston gave to an unconnected company on 1 February 2015. Twelve month expected credit losses were estimated at $1 million and have been charged to administrative expenses. The coupon and effective rate of interest were both 8%. Interest was received on 31 January 2016 and recorded correctly in the consolidated financial statements despite a significant deterioration in economic conditions within the industry of the unconnected company. As a result, the investment is to be downgraded with an expected 40% chance of default on the remaining cash flows. No entry has yet been made to downgrade the investment in the consolidated financial statements.

(viii) Included within the trade and other payables at 31 January 2015 was contingent consideration of $10 million. A discount rate of 10% was used to measure the fair value of this obligation. This arose on the acquisition of Eastern, a subsidiary acquired several years ago. The consideration to be paid was contingent on the profits of Eastern. Eastern did not perform as well as expected during the year and Weston paid $7 million in full and final settlement of the obligation on 31 January 2016.

(ix) Weston did not pay a dividend to its shareholders during the year ended 31 January 2016.

Required:

(a) Prepare a group statement of cash flows using the indirect method for the Weston group for the year ended 31 January 2016 in accordance with the requirements of IAS 7 *Statement of Cash Flows*. (35 marks)

(b) The directors of Weston are looking at the requirements of IFRS for SMEs and FRS 102, *The Financial Reporting Standard applicable in the UK and Republic of Ireland*, with regards to accounting for goodwill including the impact of a bargain purchase. The directors would like advice on this issue as the entity is preparing to purchase an Irish subsidiary at a competitive price.

Required:

Describe the key differences in accounting for goodwill under IFRS for SMEs and FRS 102. (8 marks)

(c) Shortly before 31 January 2016, Weston gave a $5 million, zero interest, short-term loan to its subsidiary, Eastern. Eastern repaid the loan in full during February 2016. Since the loan was repaid within Weston's usual credit terms of 30 days, it was classified as a trading item as at 31 January 2016. Consequently Weston included the balance within trade and other receivables and Eastern included it within trade and other payables at the year end. Eastern has several bank loans with substantial debt covenants linked to both interest cover and its gearing ratio. The bank loans would have become immediately repayable should Eastern breach any of the terms of the covenants. Before receiving the loan, Eastern had a bank overdraft balance of $4·5 million.

Required:

Discuss the impact which the $5 million loan would have on the debt covenants of Eastern and whether there are any ethical implications arising from the situation. You do not need to adjust your answer to part (a) in relation to this issue. (7 marks)

(50 marks)

Section B – TWO questions ONLY to be attempted

2 **(a)** Mehran, a public limited company, has just acquired a company, which comprises a farming and mining business. Mehran wishes advice on how to fair value some of the assets acquired.

(i) One such asset is a piece of land, which is currently used for farming. The fair value of the land if used for farming is $5 million. If the land is used for farming purposes, a tax credit currently arises annually, which is based upon the lower of 15% of the fair market value of land or $500,000 at the current tax rate. The current tax rate in the jurisdiction is 20%.

Mehran has determined that market participants would consider that the land could have an alternative use for residential purposes. The fair value of the land for residential purposes before associated costs is thought to be $7·4 million. In order to transform the land from farming to residential use, there would be legal costs of $200,000, a viability analysis cost of $300,000 and costs of demolition of the farm buildings of $100,000. Additionally, permission for residential use has not been formally given by the legal authority and because of this, market participants have indicated that the fair value of the land, after the above costs, would be discounted by 20% because of the risk of not obtaining planning permission.

In addition, Mehran has acquired the brand name associated with the produce from the farm. Mehran has decided to discontinue the brand on the assumption that it will gain increased revenues from its own brands. Mehran has determined that if it ceases to use the brand, then the indirect benefits will be $20 million. If it continues to use the brand, then the direct benefit will be $17 million. (8 marks)

(ii) Mehran wishes to fair value the inventory of the entity acquired. There are three different markets for the produce, which are mainly vegetables. The first is the local domestic market where Mehran can sell direct to retailers of the produce. The second domestic market is one where Mehran sells directly to manufacturers of canned vegetables. There are no restrictions on the sale of produce in either of the domestic markets other than the demand of the retailers and manufacturers. The final market is the export market but the government limits the amount of produce which can be exported. Mehran needs a licence from the government to export its produce. Farmers tend to sell all of the produce that they can in the export market and, when they do not have any further authorisation to export, they sell the remaining produce in the two domestic markets.

It is difficult to obtain information on the volume of trade in the domestic market where the produce is sold locally direct to retailers but Mehran feels that the market is at least as large as the domestic market – direct to manufacturers. The volumes of sales quoted below have been taken from trade journals.

	Domestic market – direct to retailers	**Domestic market – direct to manufacturers**	**Export market**
Volume – annual	Unknown	20,000 tonnes	10,000 tonnes
Mehran – sales per month	10 tonnes	4 tonnes	60 tonnes
Price per tonne	$1,000	$800	$1,200
Transport costs per tonne	$50	$70	$100
Selling agents' fees per tonne	–	$4	$6

(9 marks)

Required:

Discuss the way in which Mehran should fair value the above assets with reference to the principles of IFRS 13 *Fair Value Measurement*.

Note: The mark allocation is shown against each of the two issues above.

(b) Mehran has an Irish subsidiary which has by law to provide a pension scheme for its employees. A lump-sum benefit is payable on termination of service and is equal to 1% of final salary for each year of service. Mehran has given you details of a typical entrant to the scheme. An employee earning $30,000 at present would be expected to earn a salary of $39,300 at the end of five years.

Given a discount rate of 10%, Mehran would like to know what the current service cost would be in the current year for such an employee who retires after five years and wishes to know if there are any differences between accounting for pensions under IFRS for SMEs and FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland*.

Required

Advise Mehran on the issues raised above. (6 marks)

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

(25 marks)

3 **(a)** Emcee, a public limited company, is a sports organisation which owns several football and basketball teams. It has a financial year end of 31 May 2016. Emcee needs a new stadium to host sporting events which will be included as part of Emcee's property, plant and equipment. Emcee therefore commenced construction on a new stadium on 1 February 2016, and this continued until its completion which was after the year end of 31 May 2016. The direct costs were \$20 million in February 2016 and then \$50 million in each month until the year end. Emcee has not taken out any specific borrowings to finance the construction of the stadium, but it has incurred finance costs on its general borrowings during the period, which could have been avoided if the stadium had not been constructed. Emcee has calculated that the weighted average cost of borrowings for the period 1 February–31 May 2016 on an annualised basis amounted to 9% per annum. Emcee needs advice on how to treat the borrowing costs in its financial statements for the year ending 31 May 2016. (6 marks)

(b) Emcee purchases and sells players' registrations on a regular basis. Emcee must purchase registrations for that player to play for the club. Player registrations are contractual obligations between the player and Emcee. The costs of acquiring player registrations include transfer fees, league levy fees, and player agents' fees incurred by the club. Often players' former clubs are paid amounts which are contingent upon the performance of the player whilst they play for Emcee. For example, if a contracted basketball player scores an average of more than 20 points per game in a season, then an additional \$5 million may become payable to his former club. Also, players' contracts can be extended and this incurs additional costs for Emcee.

At the end of every season, which also is the financial year end of Emcee, the club reviews its playing staff and makes decisions as to whether they wish to sell any players' registrations. These registrations are actively marketed by circulating other clubs with a list of players' registrations and their estimated selling price. Players' registrations are also sold during the season, often with performance conditions attached. Occasionally, it becomes clear that a player will not play for the club again because of, for example, a player sustaining a career threatening injury or being permanently removed from the playing squad for another reason. The playing registrations of certain players were sold after the year end, for total proceeds, net of associated costs, of \$25 million. These registrations had a net book value of \$7 million.

Emcee would like to know the financial reporting treatment of the acquisition, extension, review and sale of players' registrations in the circumstances outlined above. (10 marks)

(c) Emcee uses the revaluation model to measure its stadiums. The directors have been offered \$100 million from an airline for the property naming rights of all the stadiums for three years. There are two directors who are on the management boards of Emcee and the airline. Additionally, there are regulations in place by both the football and basketball leagues which regulate the financing of the clubs. These regulations prevent capital contributions from a related party which 'increases equity without repayment in return'. The aim of these regulations is to promote sustainable business models. Sanctions imposed by the regulator include fines and withholding of prize monies. Emcee wishes to know how to take account of the naming rights in the valuation of the stadium and the potential implications of the financial regulations imposed by the leagues. (7 marks)

Required:

Discuss how the above events would be shown in the financial statements of Emcee under International Financial Reporting Standards.

Note: The split of the mark allocation is shown against each of the three issues above.

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

(25 marks)

4 The introduction of a new accounting standard can have significant impact on an entity by changing the way in which financial statements show particular transactions or events. In many ways, the impact of a new accounting standard requires the same detailed consideration as is required when an entity first moves from local Generally Accepted Accounting Practice to International Financial Reporting Standards (IFRS).

A new or significantly changed accounting standard often provides the key focus for examination of the financial statements of listed companies by national enforcers who issue common enforcement priorities. These priorities are often highlighted because of significant changes to accounting practices as a result of new or changed standards or because of the challenges faced by entities as a result of the current economic environment. Recent priorities have included recognition and measurement of deferred tax assets and impairment of financial and non-financial assets.

Required:

(a) (i) Discuss the key practical considerations, and financial statement implications which an entity should consider when implementing a move to a new IFRS. (7 marks)

(ii) Discuss briefly the reasons why regulators might focus on the impairment of non-financial assets and deferred tax assets in a period of slow economic growth, setting out the key areas which entities should focus on when accounting for these elements. (8 marks)

(b) Pod is a listed company specialising in the distribution and sale of photographic products and services. Pod's statement of financial position included an intangible asset which was a portfolio of customers acquired from a similar business which had gone into liquidation. Pod changed its assessment of the useful life of this intangible asset from 'finite' to 'indefinite'. Pod felt that it could not predict the length of life of the intangible asset, stating that it was impossible to foresee the length of life of this intangible due to a number of factors such as technological evolution, and changing consumer behaviour.

Pod has a significant network of retail branches. In its financial statements, Pod changed the determination of a cash generating unit (CGU) for impairment testing purposes at the level of each major product line, rather than at each individual branch. The determination of CGUs was based on the fact that each of its individual branches did not operate on a standalone basis as some income, such as volume rebates, and costs were dependent on the nature of the product line rather than on individual branches. Pod considered that cash inflows and outflows for individual branches did not provide an accurate assessment of the actual cash generated by those branches. Pod, however, has daily sales information and monthly statements of profit or loss produced for each individual branch and this information is used to make decisions about continuing to operate individual branches.

Required:

Discuss whether the changes to accounting practice suggested by Pod are acceptable under International Financial Reporting Standards. (8 marks)

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

(25 marks)

End of Question Paper