Professional Level – Essentials Module

Corporate Reporting (Irish)

Tuesday 14 December 2010

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

This 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 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.

The Association of Chartered Certified Accountants

Paper P2 (IRL)

ACCA

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

1 The following draft group financial statements relate to Jocatt, a public limited company:

Jocatt Group: Balance Sheet as at 30 November

	2010 €m	2009 €m
Fixed Assets		
Tangible fixed assets	327	254
Investment property	8	6
Goodwill	48	68
Intangible assets	85	72
Investment in associate	54	–
Available-for-sale financial assets	94	90
	616	490
Current assets		
Stock and work-in-progress	105	128
Trade debtors	62	113
Cash at bank and in hand	232	143
	399	384
Creditors: amounts falling due within one year		
Trade creditors	144	55
Current tax payable	33	30
	(177)	(85)
Net current assets	222	299
Total assets less current liabilities	838	789
Creditors: amounts falling due after more than one year		
Long-term borrowings	67	71
Deferred tax	35	41
Long-term provisions-pension liability	25	22
	(127)	(134)
Net assets	711	655
Capital and reserves		
Share capital	290	275
Profit and loss reserve	349·5	324
Other reserves	16·5	20
Total shareholders funds	656	619
Minority interest	55	36
Capital employed	711	655

Jocatt Group: Profit and Loss Account for the year ended 30 November 2010

	€m
Turnover	432
Cost of sales	(317)
Gross profit	115
Other income	25
Distribution costs	(55·5)
Administrative expenses	(36)
Interest paid	(6)
Gains on property	9
Share of profit of associate	6
Profit on ordinary activities before tax	57·5
Tax on ordinary activities	(11)
Profit for the year on ordinary activities	46·5
Minority interest	(10)
Profit for year	36·5

Statement of group total recognised gains and losses for the year ended 30 November 2010 (after tax)

	€m
Profit for financial year	36·5
Gain on available-for-sale financial assets (AFS)	2
Losses on property revaluation	(7)
Investment property gain	1·5
Actuarial losses on defined benefit plan	(6)
Total recognised gains and losses for the year	27

Reconciliation of movements in group shareholders' funds for year ended 30 November 2010

	€m
Profit for the financial year	36·5
Dividends	(5)
Other recognised gains and losses for the year (above)	(9·5)
Proceeds of ordinary shares for cash	15
Net addition to shareholders' funds	37
Shareholders' funds at 30 November 2009	619
Shareholders' funds at 30 November 2010	656

The following information relates to the financial statements of Jocatt:

(i) On 1 December 2008, Jocatt acquired 8% of the ordinary shares of Tigret. Jocatt had treated this investment as available-for-sale in the financial statements to 30 November 2009. On 1 December 2009, Jocatt acquired a further 52% of the ordinary shares of Tigret and gained control of the company. The consideration for the acquisitions was as follows:

	Holding	Consideration €m
1 December 2008	8%	5
1 December 2009	52%	32·6
	60%	37·6

At 1 December 2009, the fair value of the 8% holding in Tigret held by Jocatt at the time of the business combination was €6 million. No gain or loss on the 8% holding in Tigret had been reported in the financial statements at 1 December 2009. The purchase consideration at 1 December 2009 comprised cash of €17·6 million and shares of €15 million.

The fair value of the identifiable net assets of Tigret, excluding deferred tax assets and liabilities, at the date of acquisition comprised the following:

	€m
Property, plant and machinery	15
Intangible assets	18
Trade debtors	5
Cash	7

The tax written down value of the identifiable net assets of Tigret was €40 million at 1 December 2009. The tax rate of Tigret is 30%.

(ii) On 30 November 2010, Tigret made a rights issue on a 1 for 4 basis. The issue was fully subscribed and raised €5 million in cash.

(iii) Jocatt purchased a research project from a third party including certain patents on 1 December 2009 for €8 million and recognised it as an intangible asset as Jocatt chooses to capitalise expenditure wherever possible. During the year, Jocatt incurred further costs, which included €2 million on completing the research phase, €4 million in developing the product for sale and €1 million for the initial marketing costs. There were no other additions to intangible assets in the period other than those on the acquisition of Tigret.

(iv) Jocatt operates a defined benefit scheme. The current service costs for the year ended 30 November 2010 are €10 million. Jocatt enhanced the benefits on 1 December 2009 at a cost of €2 million. These benefits vest immediately. The expected return on plan assets was €8 million for the year.

(v) Jocatt owns an investment property. During the year, part of the heating system of the property, which had a carrying value of €0·5 million, was replaced by a new system, which cost €1 million.

(vi) Jocatt had exchanged surplus land with a carrying value of €10 million for cash of €15 million and plant valued at €4 million. The transaction has commercial substance. Depreciation for the period for tangible fixed assets was €27 million.

(vii) Goodwill relating to subsidiaries is not amortised but had been impairment tested in the year to 30 November 2010 and any impairment accounted for.

(viii) Deferred tax of €1 million arose on the gains on available-for-sale investments in the year.

(ix) The associate did not pay any dividends in the year.

(x) The movement on the profit and loss reserve and other reserves was as follows:

	Profit/loss reserves	Other reserve
	€m	€m
Opening balance at 1 December 2009	324	20
Profit for financial year	36·5	
Available-for-sale financial asset – net gain		2
Losses on property revaluation		(7)
Dividends paid	(5)	
Actuarial loss on defined benefit scheme	(6)	
Gain on investment property		1·5
Closing balance at 30 November 2010	349·5	16·5

Required:

(a) Prepare a group cash flow statement for the Jocatt Group using the indirect method under FRS 1 'Cash Flow Statements'.

Note: Ignore deferred taxation other than where it is mentioned in the question. (35 marks)

(b) Jocatt operates in the energy industry and undertakes complex natural gas trading arrangements, which involve exchanges in resources with other companies in the industry. Jocatt is entering into a long-term contract for the supply of gas and is raising a loan on the strength of this contract. The proceeds of the loan are to be received over the year to 30 November 2011 and are to be repaid over four years to 30 November 2015. Jocatt wishes to report the proceeds as operating cash flow because it is related to a long-term purchase contract. The directors of Jocatt receive extra income if the operating cash flow exceeds a predetermined target for the year and feel that the indirect method is more useful and informative to users of financial statements than the direct method.

(i) Comment on the directors' view that the indirect method of preparing cash flow statements is more useful and informative to users than the direct method. (7 marks)

(ii) Discuss the reasons why the directors may wish to report the loan proceeds as an operating cash flow rather than a financing cash flow and whether there are any ethical implications of adopting this treatment. (6 marks)

Professional marks will be awarded in part (b) for the clarity and quality of discussion. (2 marks)

(50 marks)

Section B – TWO questions ONLY to be attempted

2 Margie, a public limited company, has entered into several share related transactions during the period and wishes to obtain advice on how to account for the transactions.

(a) Margie has entered into a contract with a producer to purchase 350 tonnes of wheat. The purchase price will be settled in cash at an amount equal to the value of 2,500 of Margie's shares. Margie may settle the contract at any time by paying the producer an amount equal to the current market value of 2,500 of Margie shares, less the market value of 350 tonnes of wheat. Margie has entered into the contract as part of its hedging strategy and has no intention of taking physical delivery of the wheat. Margie wishes to treat this transaction as a share-based payment transaction under FRS 20 'Share-based Payment'. (7 marks)

(b) Margie has acquired 100% of the share capital of Antalya in a business combination on 1 December 2009. Antalya had previously granted a share-based payment to its employees with a four-year vesting period. Its employees have rendered the required service for the award at the acquisition date but have not yet exercised their options. The fair value of the award at 1 December 2009 is €20 million and Margie is obliged to replace the share-based payment awards of Antalya with awards of its own.

Margie issues a replacement award that does not require post-combination services. The fair value of the replacement award at the acquisition date is €22 million. Margie does not know how to account for the award on the acquisition of Antalya. (6 marks)

(c) Margie issued shares during the financial year. Some of those shares were subscribed for by employees who were existing shareholders, and some were issued to an entity, Grief, which owned 5% of Margie's share capital. Before the shares were issued, Margie offered to buy a building from Grief and agreed that the purchase price would be settled by the issue of shares. Margie wondered whether these transactions should be accounted for under FRS 20. (4 marks)

(d) Margie granted 100 options to each of its 4,000 employees at a fair value of €10 each on 1 December 2007. The options vest upon the company's share price reaching €15, provided the employee has remained in the company's service until that time. The terms and conditions of the options are that the market condition can be met in either year three, four or five of the employee's service.

At the grant date, Margie estimated that the expected vesting period would be four years which is consistent with the assumptions used in estimating the fair value of the options granted. The company's share price reached €15 on 30 November 2010. (6 marks)

Required:

Discuss, with suitable computations where applicable, how the above transactions would be dealt with in the financial statements of Margie for the year ending 30 November 2010.

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

(25 marks)

3 **(a)** Greenie, a public limited company, builds, develops and operates airports. During the financial year to 30 November 2010, a section of an airport collapsed and, as a result, several people were hurt. The accident resulted in the closure of the terminal and legal action against Greenie. When the financial statements for the year ended 30 November 2010 were being prepared, the investigation into the accident and the reconstruction of the section of the airport damaged were still in progress and no legal action had yet been brought in connection with the accident. The expert report that was to be presented to the civil courts in order to determine the cause of the accident and to assess the respective responsibilities of the various parties involved, was expected in 2011.

Financial damages arising related to the additional costs and operating losses relating to the unavailability of the building. The nature and extent of the damages, and the details of any compensation payments had yet to be established. The directors of Greenie felt that at present, there was no requirement to record the impact of the accident in the financial statements.

Compensation agreements had been arranged with the victims, and these claims were all covered by Greenie's insurance policy. In each case, compensation paid by the insurance company was subject to a waiver of any judicial proceedings against Greenie and its insurers. If any compensation is eventually payable to third parties, this is expected to be covered by the insurance policies.

The directors of Greenie felt that the conditions for recognising a provision or disclosing a contingent liability had not been met. Therefore Greenie did not recognise a provision in respect of the accident nor did it disclose any related contingent liability or a note setting out the nature of the accident and potential claims in its financial statements for the year ended 30 November 2010. (6 marks)

(b) Greenie was one of three shareholders in a regional airport, Manair. As at 30 November 2010, the majority shareholder held 60·1% of voting shares, the second shareholder held 20% of voting shares and Greenie held 19·9% of voting shares. The board of directors consisted of ten members. The majority shareholder was represented by six of the board members, while Greenie and the other shareholder were represented by two members each. A shareholders' agreement stated that certain board and shareholder resolutions required either unanimous or majority decision. There is no indication that the majority shareholder and the other shareholders act together in a common way. During the financial year, Greenie had provided Manair with maintenance and technical services and had sold the entity a software licence for €5 million. Additionally, Greenie had sent a team of management experts to give business advice to the board of Manair. Greenie did not account for its investment in Manair as an associate, because of a lack of significant influence over the entity. Greenie felt that the majority owner of Manair used its influence as the parent to control and govern its subsidiary. (10 marks)

(c) Greenie has issued 1 million shares of €1 nominal value for the acquisition of franchise rights at a local airport. Similar franchise rights are sold in cash transactions on a regular basis and Greenie has been offered a similar franchise right at another airport for €2·3 million. This price is consistent with other prices given the market conditions. The share price of Greenie was €2·50 at the date of the transaction. Greenie wishes to record the transaction at the nominal value of the shares issued.

Greenie also showed irredeemable preference shares as equity instruments in its balance sheet. The terms of issue of the instruments give the holders a contractual right to an annual fixed cash dividend and the entitlement to a participating dividend based on any dividends paid on ordinary shares. Greenie felt that the presentation of the preference shares with a liability component in compliance with FRS 25 'Financial Instruments: Presentation' would be so misleading in the circumstances that it would conflict with the objective of financial statements set out in the ASB's 'Statement of Principles'. The reason given by Greenie for this presentation was that the shares participated in future profits and thus had the characteristics of permanent capital because of the profit participation element of the shares. (7 marks)

Required:

Discuss how the above financial transactions should be dealt with in the financial statements of Greenie for the year ended 30 November 2010.

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

(25 marks)

4 **(a)** The principal aim when developing accounting standards for small to medium-sized entities (SMEs) is to provide a framework that generates relevant, reliable, and useful information which should provide a high quality and understandable set of accounting standards suitable for SMEs. There is no universally agreed definition of an SME and it is difficult for a single definition to capture all the dimensions of a small or medium-sized business. The main argument for separate SME accounting standards is the undue cost burden of reporting, which is proportionately heavier for smaller firms.

Required:

(i) **Discuss the different approaches, principles and considerations which should be taken into account in developing an accounting standard for SMEs.** (6 marks)

(ii) **Evaluate the main arguments for separate SME accounting standards and discuss whether an entity's size is the ideal criterion for defining an SME.** (7 marks)

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

(b) Havata is a small entity that adopts RoI GAAP. Havata has had considerable growth over the last few years and is looking to obtain a listing on the Stock Exchange. It realises that the financial statements will have to comply with International Financial Reporting Standards (IFRS). The directors would like advice on how to account for the following two transactions taking into account that it wishes to gain a Stock Exchange listing.

(i) Havata has a non-specialised property and has a policy of revaluation. The revalued cost and associated accumulated depreciation as at 1 November 2009 were €16 million (€2 million land and €14 million buildings) and €1·5 million respectively. Buildings have an original useful life of 50 years.

Havata operates in fiercely competitive conditions as the industry is in temporary decline. Havata's directors have obtained the following valuations from an independent surveyor.

	Land	Buildings
	€m	€m
Open market value	1·5	8·5
Value in use	1·5	9·2
Existing use value	1·5	7·8

If Havata decides to sell the property it would incur selling costs of 2·5%. IFRS treatment of this property in this instance is that a property shall not be carried at more than recoverable amount which is effectively the higher of an asset's net selling price and its value in use. Ignore the impact of deferred taxation. (5 marks)

(ii) IFRS requires investment property to be measured at fair value with gains on fair value reported in profit or loss or on a 'cost' basis similar to that in FRS 15 *Tangible fixed assets*. Fair value is defined as the price at which the property can be exchanged between knowledgeable, willing parties in an arm's length transaction. This generally means the highest and best value that can be gained for the asset.

The company owns an investment property which comprises land and an old hotel. The company currently adopts SSAP 19 *Investment Property*. The property was purchased on 1 December 2009 for €9 million (land €8·7 million and building €0·3 million). Properties of this type were deemed to have a useful life of 50 years. The carrying value of the property at market value at 30 November 2010 is €10 million (land valuation €9·5 million, building €0·5 million). The company could sell the land for redevelopment for housing for €15 million and this would involve demolishing the hotel. Alternatively, Harvata could demolish the hotel itself at a cost of €200,000 and sell it for €15·1 million. Under IFRS deferred tax is provided on revaluation gains. The tax rate applicable to Havata is 30%. (5 marks)

Required:

Discuss the accounting implications of Havata using RoI GAAP rather than IFRS in the financial statements for the year ended 30 November 2010.

(25 marks)

End of Question Paper