Professional Level – Essentials Module

Corporate Reporting (Irish)

Tuesday 13 December 2011

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 Traveler, a public limited company, operates in the manufacturing sector. The draft statements of financial position are as follows at 30 November 2011:

	Traveler $m	Data $m	Captive $m
Assets:			
Non-current assets			
Property, plant and equipment	439	810	620
Investments in subsidiaries			
Data	820		
Captive	541		
Financial assets	108	10	20
	1,908	820	640
Defined benefit asset	72		
Current assets	995	781	350
Total assets	2,975	1,601	990
Equity and liabilities:			
Share capital	1,120	600	390
Retained earnings	1,066	442	169
Other components of equity	60	37	45
Total equity	2,246	1,079	604
Non-current liabilities	455	323	73
Current liabilities	274	199	313
Total liabilities	729	522	386
Total equity and liabilities	2,975	1,601	990

The following information is relevant to the preparation of the group financial statements:

1 On 1 December 2010, Traveler acquired 60% of the equity interests of Data, a public limited company. The purchase consideration comprised cash of $600 million. At acquisition, the fair value of the non-controlling interest in Data was $395 million. Traveler wishes to use the 'full goodwill' method. On 1 December 2010, the fair value of the identifiable net assets acquired was $935 million and retained earnings of Data were $299 million and other components of equity were $26 million. The excess in fair value is due to non-depreciable land.

   On 30 November 2011, Traveler acquired a further 20% interest in Data for a cash consideration of $220 million.

2 On 1 December 2010, Traveler acquired 80% of the equity interests of Captive for a consideration of $541 million. The consideration comprised cash of $477 million and the transfer of non-depreciable land with a fair value of $64 million. The carrying amount of the land at the acquisition date was $56 million. At the year end, this asset was still included in the non-current assets of Traveler and the sale proceeds had been credited to profit or loss.

   At the date of acquisition, the identifiable net assets of Captive had a fair value of $526 million, retained earnings were $90 million and other components of equity were $24 million. The excess in fair value is due to non-depreciable land. This acquisition was accounted for using the partial goodwill method in accordance with IFRS 3 (Revised) *Business Combinations*.

3 Goodwill was impairment tested after the additional acquisition in Data on 30 November 2011. The recoverable amount of Data was $1,099 million and that of Captive was $700 million.

4 Included in the financial assets of Traveler is a ten-year 7% loan. At 30 November 2011, the borrower was in financial difficulties and its credit rating had been downgraded. Traveler has adopted IFRS 9 *Financial Instruments* and the loan asset is currently held at amortised cost of $29 million. Traveler now wishes to value the loan at fair value using current market interest rates. Traveler has agreed for the loan to be restructured; there will only be three more annual payments of $8 million starting in one year's time. Current market interest rates are 8%, the original effective interest rate is 6·7% and the effective interest rate under the revised payment schedule is 6·3%.

5 Traveler acquired a new factory on 1 December 2010. The cost of the factory was $50 million and it has a residual value of $2 million. The factory has a flat roof, which needs replacing every five years. The cost of the roof was $5 million. The useful economic life of the factory is 25 years. No depreciation has been charged for the year. Traveler wishes to account for the factory and roof as a single asset and depreciate the whole factory over its economic life. Traveler uses straight-line depreciation.

6 The actuarial value of Traveler's pension plan showed a surplus at 1 December 2010 of $72 million, represented by the fair value of the assets of $250 million, the present value of the defined benefit obligation of $200 million and net unrecognised actuarial losses of $22 million. The average remaining working lives of the employees is 10 years. Traveler uses the corridor approach for recognising actuarial gains and losses. The aggregate of the current service cost, interest cost and expected return on assets amounted to a cost of $55 million for the year. After consulting with the actuaries, the company decided to reduce its contributions for the year to $45 million. The contributions were paid on 7 December 2011. No entries had been made in the financial statements for the above amounts. At the year end, the unrecognised actuarial losses were $20 million and the present value of available future refunds and reductions in future contributions was $18 million.

Required:

(a) Prepare a consolidated statement of financial position for the Traveler Group for the year ended 30 November 2011. (35 marks)

(b) Traveler has three distinct business segments. Having only recently moved to IFRS, they are unsure as to the key differences between the UK standard SSAP 25 *Segmental reporting* and IFRS 8 *Operating Segments*.

Required:

Advise the management of Traveler of the key differences between SSAP 25 and IFRS 8. (7 marks)

(c) Segmental information reported externally is more useful if it conforms to information used by management in making decisions. The information can differ from that reported in the financial statements. Although reconciliations are required, these can be complex and difficult to understand. Additionally, there are other standards where subjectivity is involved and often the profit motive determines which accounting practice to follow. The directors have a responsibility to shareholders in disclosing information to enhance corporate value but this may conflict with their corporate social responsibility.

Required:

Discuss how the ethics of corporate social responsibility disclosure are difficult to reconcile with shareholder expectations. (6 marks)

Professional marks will be awarded in part (c) for clarity and expression of your discussion. (2 marks)

(50 marks)

Section B – TWO questions ONLY to be attempted

2 Decany owns 100% of the ordinary share capital of Ceed and Rant. All three entities are public limited companies. The group operates in the shipbuilding industry, which is currently a depressed market. Rant has made losses for the last three years and its liquidity is poor. The view of the directors is that Rant needs some cash investment. The directors have decided to put forward a restructuring plan as at 30 November 2011. Under this plan:

1. Ceed is to purchase the whole of Decany's investment in Rant. The purchase consideration is to be $98 million payable in cash to Decany and this amount will then be loaned on a long-term unsecured basis to Rant; and
2. Ceed will purchase land with a carrying amount of $10 million from Rant for a total purchase consideration of $15 million. The land has a mortgage outstanding on it of $4 million. The total purchase consideration of $15 million comprises five million $1 nominal value non-voting shares issued by Ceed to Rant and the $4 million mortgage liability which Ceed will assume; and
3. A dividend of $25 million will be paid from Ceed to Decany to reduce the accumulated reserves of Ceed.

The Statements of Financial Position of Decany and its subsidiaries at 30 November 2011 are summarised below:

	Decany $m	Ceed $m	Rant $m
Non-current assets			
Tangible non-current assets at depreciated cost/valuation	600	170	45
Cost of investment in Ceed	130		
Cost of investment in Rant	95		
Current assets	155	130	20
	980	300	65
Equity and reserves			
Share capital	140	70	35
Retained earnings	750	220	5
	890	290	40
Non-current liabilities			
Long-term loan	5		12
Current liabilities			
Trade payables	85	10	13
	980	300	65

As a result of the restructuring, several of Ceed's employees will be made redundant. According to the detailed plan, the costs of redundancy will be spread over two years with $4 million being payable in one year's time and $6 million in two years' time. The market yield of high quality corporate bonds is 3%. The directors feel that the overall restructure will cost $2 million.

As Ceed is now a holding company, the directors are unsure as to the requirements to prepare group accounts under RoI Company law. All companies are incorporated in the Republic of Ireland, but are not listed on any EU stock exchange.

Required:

(a) (i) Prepare the individual entity statements of financial position after the proposed restructuring plan; (13 marks)

(ii) Set out the requirements of RoI law as regards the requirement to produce group accounts, advising the directors as to the position of Ceed. (5 marks)

(b) Discuss the key implications of the proposed plans for the restructuring of the group. (5 marks)

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

(25 marks)

3 Scramble, a public limited company, is the largest developer of online computer games.

(a) At 30 November 2011, 65% of Scramble's total assets were mainly represented by internally developed intangible assets comprising the capitalised costs of the development and production of online computer games. These games generate all of Scramble's revenue. The costs incurred in relation to maintaining the games at the same standard of performance are expensed to the statement of comprehensive income. The accounting policy note states that intangible assets are valued at historical cost. Scramble considers the games to have an indefinite useful life, which is reconsidered annually when the intangible assets are tested for impairment. Scramble determines value in use using the estimated future cash flows which include maintenance expenses, capital expenses incurred in developing different versions of the games and the expected increase in revenue resulting from the above mentioned cash outflows. Scramble does not conduct an analysis or investigation of differences between expected and actual cash flows. Tax effects were also taken into account. (7 marks)

(b) Scramble has two cash generating units (CGU) which hold 90% of the internally developed intangible assets. Scramble reported a consolidated net loss for the period and an impairment charge in respect of the two CGUs representing 63% of the consolidated profit before tax and 29% of the total costs in the period. The recoverable amount of the CGUs is defined, in this case, as value in use. Specific discount rates are not directly available from the market, and Scramble estimates the discount rates, using its weighted average cost of capital. In calculating the cost of debt as an input to the determination of the discount rate, Scramble used the risk-free rate adjusted by the company specific average credit spread of its outstanding debt, which had been raised two years previously. As Scramble did not have any need for additional financing and did not need to repay any of the existing loans before 2014, Scramble did not see any reason for using a different discount rate. Scramble did not disclose either the events and circumstances that led to the recognition of the impairment loss or the amount of the loss recognised in respect of each cash-generating unit. Scramble felt that the events and circumstances that led to the recognition of a loss in respect of the first CGU were common knowledge in the market and the events and the circumstances that led to the recognition loss of the second CGU were not needed to be disclosed. (7 marks)

(c) Scramble wished to diversify its operations and purchased a professional football club, Rashing. In Rashing's financial statements for the year ended 30 November 2011, it was proposed to include significant intangible assets which related to acquired players' registration rights comprising registration and agents' fees. The agents' fees were paid by the club to players' agents either when a player is transferred to the club or when the contract of a player is extended. Scramble believes that the registration rights of the players are intangible assets but that the agents fees do not meet the criteria to be recognised as intangible assets as they are not directly attributable to the costs of players' contracts. Additionally, Rashing has purchased the rights to 25% of the revenue from ticket sales generated by another football club, Santash, in a different league. Rashing does not sell these tickets nor has any discretion over the pricing of the tickets. Rashing wishes to show these rights as intangible assets in its financial statements. (9 marks)

Required:

Discuss the validity of the accounting treatments proposed by Scramble in its financial statements for the year ended 30 November 2011.

The mark allocation is shown against each of the three accounting treatments above.

Professional marks will be awarded for clarity and expression of your discussion. (2 marks)

(25 marks)

4 It is argued that there is limited revenue recognition guidance available from IFRS with many companies following the current provisions of US GAAP. The revenue recognition standard, IAS 18 *Revenue*, has been criticised because an entity applying the standards might recognise amounts in the financial statements that do not faithfully represent the nature of the transactions. It has been further argued that current standards are inconsistent with principles used in other accounting standards, and further that the notion of the risks and rewards of ownership has also been subjectively applied in sale transactions.

Required:

(a) (i) Discuss the main weaknesses in the current standard on revenue recognition; (11 marks)

(ii) Discuss the reasons why it might be relevant to take into account credit risk and the time value of money in assessing revenue recognition. (5 marks)

Professional marks will be awarded in part (a) for clarity and expression of your discussion. (2 marks)

(b) (i) Venue enters into a contract with a customer to provide computers at a value of $1 million. The terms are that payment is due one month after the sale of the goods. On the basis of experience with other contractors with similar characteristics, Venue considers that there is a 5% risk that the customer will not pay the amount due after the goods have been delivered and the property transferred. Venue subsequently felt that the financial condition of the customer has deteriorated and that the trade receivable is further impaired by $100,000.

(ii) Venue has also sold a computer hardware system to a customer and, because of the current difficulties in the market, Venue has agreed to defer receipt of the selling price of $2 million until two years after the hardware has been transferred to the customer.

Venue has also been offering discounts to customers if products were sold with terms whereby payment was due now but the transfer of the product was made in one year. A sale had been made under these terms and payment of $3 million had been received. A discount rate of 4% should be used in any calculations.

Required:

Discuss how both of the above transactions would be treated in subsequent financial statements under IAS 18 and also whether there would be difference in treatment if the collectability of the debt and the time value of money were taken into account. (7 marks)

(25 marks)

End of Question Paper