Professional Level – Essentials Module

Corporate Reporting (Irish)

September/December 2017 – Sample Questions

Paper P2 (IRL)

Time allowed: 3 hours 15 minutes

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.

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

Think Ahead ACCA

The Association of Chartered Certified Accountants

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

1 (a) Moorland has investments in Lyndhurst and Tybull and all three are public limited companies. Tybull is located overseas and uses the dinar as its functional and presentation currency.

Draft statements of profit or loss and other comprehensive income for the year ended 30 June 2017

	Moorland	Lyndhurst	Tybull
	$m	$m	dinar
Revenue	580	202	540
Cost of sales	(376)	(96)	(296)
Gross profit	204	106	244
Administrative costs	(95)	(24)	(52)
Other expenses	(39)	(20)	(40)
Operating profit	70	62	152
Net finance costs	(12)	(6)	(16)
Profit before tax	58	56	136
Income tax expense	(18)	(12)	(28)
Profit for the year	40	44	108
Other comprehensive income			
Items that will not be reclassified to profit or loss			
Gains on property revaluation	0	17	0
Total comprehensive income for year	40	61	108

The following information is relevant to the preparation of the group statement of profit or loss and other comprehensive income:

1. Moorland had acquired 40% of the equity interests in Lyndhurst for a cost of $100 million on 1 July 2015. On 1 July 2016, Moorland acquired a further 20% of the equity interests for $64 million and obtained control. The net assets of Lyndhurst had a carrying amount of $230 million and $250 million on 1 July 2015 and 1 July 2016 respectively. No fair value adjustments were required to the net assets at either date. The fair value of the original 40% equity interest at 1 July 2016 is deemed to be $115 million. This amount is also the fair value of the non-controlling interest at 1 July 2016. The only entries in Moorland's financial statements in relation to this transaction have been to record the investment at cost including $2 million of legal fees which have been capitalised as part of the $64 million investment. Moorland has a policy of valuing the non-controlling interest at fair value for all subsidiaries.
2. Moorland acquired 100% of the equity interests in Tybull for a cost of dinar 990 million on 1 July 2016. The fair value of the net assets at acquisition were dinar 888 million. This differed from the carrying amount of the net assets at acquisition due to plant which had a fair value of dinar 48 million in excess of its carrying amount. This plant had a remaining useful life of two years at 1 July 2016. It is group policy to classify depreciation on plant as a cost of sale. Tybull has not paid any dividends since Moorland gained control and has not reported any revaluation gains since acquisition.
3. Goodwill was reviewed for impairment on 30 June 2017 and a charge of 25% should be applied to both Lyndhurst and Tybull. This is the first time that either investment has been impaired. Goodwill impairments should be included within other expenses.
4. During the year ended 30 June 2017 Tybull sold goods to Moorland for dinar 120 million. The mark-up on these goods was 60%. Moorland has 80% of these goods still within inventories as at 30 June 2017.

   Moorland and Tybull have recorded this transaction correctly within their financial statements but have not yet made any correcting adjustments required on consolidation. The tax effects in respect of this adjustment can be ignored.

5. The Moorland group has a presentation currency of the dollar ($). Exchange rates between the dollar and dinar are as follows:

	$:dinar
1 July 2016	1$:3·5 dinar
Average for year ended 30 June 2017	1$:4 dinar
30 June 2017	1$:5 dinar

6. The group has a policy of revaluing its property on an annual basis and Lyndhurst has correctly accounted for a revaluation surplus on its property in its financial statements. Moorland owns property with the following details:

	30 June 2016	30 June 2017
Carrying amount	$422 million	$386 million
Fair value	$422 million	$450 million
Tax base	$300 million	$220 million

Moorland has not yet provided for the revaluation gains and associated deferred tax for the year ended 30 June 2017. Moorland has a tax rate of 30% which is not expected to change in the foreseeable future. Revaluation gains are assumed to arise at the end of the year.

7. The following information relates to Moorland's defined benefit pension scheme:

	$m
Net pension deficit at 30 June 2016	30
Service cost for year ended 30 June 2017	15
Contributions into the scheme	9
Benefits paid in the year	7
Net pension deficit at 30 June 2017	42

The discount rate applicable to the pension scheme is 6%. No accounting entries for the pension have yet been included for the year ended 30 June 2017. There are no temporary differences arising in relation to the defined benefit scheme.

Required:

Prepare the consolidated statement of profit or loss and other comprehensive income for the Moorland Group for the year ended 30 June 2017 (35 marks)

(b) Moorland acquired an SME shortly after the year end whose only asset was specialised plant. The SME purchased an item of plant for $3 million on two years' interest-free credit. However, three months after the initial measurement of the plant, the group adopted the revaluation basis for accounting for property, plant and equipment (an appropriate discount rate is 5% per year).

Required:

Discuss how the plant should be initially recognised under IFRS for SMEs and whether there are any differences in the treatment of the change in the measurement basis of the plant under IFRS for SMEs and FRS 102 *The Financial Reporting Standard applicable in the UK and the Republic of Ireland*. (8 marks)

(c) Tybull sold goods to Moorland during the year at a 60% mark-up. Similar goods are usually sold to other parties at a mark-up of 20%. The directors of Moorland believe that no ethical issues arise as such transactions will be eliminated within the consolidated financial statements. On 31 October 2017, Moorland announced its intention to sell its shareholding in Tybull to the highest bidder.

Required:

Identify the accounting principles which should be considered when accounting for intra-group transactions in the consolidated financial statements and identify any ethical issues which may arise from the scenario. (7 marks)

(50 marks)

Section B – TWO questions ONLY to be attempted

2 **(a)** Formatt is a listed company with several investments in other entities. The directors currently misunderstand the nature of the control principle within certain International Financial Reporting Standards (IFRSs) and the *Conceptual Framework*.

During the year ended 30 November 2017, Formatt entered into a joint venture, Font, with another entity, Loft. Font was structured in such a way that all business decisions were taken by the management committee of Formatt and the only decisions which needed the approval of both Formatt and Loft were those which were outside normal operational decisions. Font was financed initially through the issue of bonds whose return was based upon the performance of the joint venture. Formatt purchased the bonds from third parties during the year. As a bondholder, Formatt has the right to appoint the general manager of the joint venture. For the year ended 30 November 2017, Formatt intends to account for Font under IFRS 11 *Joint Arrangements*.

Formatt also holds 49·1% of Protect's voting shares and accounts for Protect as an associate. Protect has 20 other shareholders, the largest of which has a shareholding of 20% and the smallest a holding of 1% of the voting shares. The shareholders have an agreement which gives the largest shareholder a right of first refusal if one of them wishes to sell its shareholding in Protect. The management committee of Protect consisted of six members of whom four were representatives of Formatt. There has not been complete shareholder representation at the last four annual general meetings of Protect.

The directors of Formatt wish to know how to account for Font and Protect in the financial statements for the year ended 30 November 2017. (8 marks)

(b) Formatt has entered into a contract with a customer to supply specialised medical equipment. Formatt has developed the equipment in conjunction with the customer but has contracted with a supplier for its manufacture. The supplier also delivers the equipment to the customer. Formatt pays the supplier directly and invoices the customer with the agreed selling price which is cost plus 25%. Any equipment defects are the responsibility of Formatt.

The directors of Formatt are unsure as to whether they should account for the whole transaction as a principal or just the profit margin as if an agent. (7 marks)

(c) On 30 November 2017, Formatt loaned $8 million to a third party at an agreed interest rate. At the same time, it sold the third party loan to Window whereby, in exchange for an immediate cash payment of $7 million, Formatt agreed to pay to Window the first $7 million plus interest collected from the third party loan. Formatt retained the right to $1 million plus interest. The 12-month expected credit losses are $300,000 and Formatt has agreed to suffer all credit losses. A receivable of $1 million has been recognised in the financial statements at 30 November 2017.

As a result of the agreement with Window, the directors of Formatt are unsure as to whether they should recognise any part of the interest bearing loan of $8 million in the statement of financial position at 30 November 2017. They understand that the *Conceptual Framework* and the Exposure Draft: *Conceptual Framework for Financial Reporting* both mention 'control' as one of the criteria for recognition of an asset but do not understand the interaction between the *Conceptual Framework* and IFRS 9 *Financial Instruments* as regards the recognition of a financial asset. (8 marks)

Required:

Advise the directors of Formatt on how the above elements should be dealt with in its financial statements with reference to relevant IFRSs and, where necessary, pronouncements on the *Conceptual Framework*.

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

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

(25 marks)

3 (a) (i) Darlatt is a public limited company with a year end of 31 August 2017. It sells wind turbines as part of a combined contract which includes a standard two-year warranty term and maintenance services for a ten-year period. In addition, Darlatt offers the option of a ten-year extension to the warranty for an additional fee which is paid at the time of the initial sale. The sales price for the combined contract is \$3·6 million and the customer will pay an additional fee of \$0·8 million for the extended warranty. If sold separately, the selling price of the wind turbine would be \$3·2 million and the selling price of the two-year warranty and ten-year maintenance service contract would be \$0·9 million. The extended warranty has a separate selling price of \$1 million.

The directors of Darlatt would like to know how the above transactions should be accounted for under IFRS 15 *Revenue from Contracts with Customers*. (8 marks)

(ii) On 1 September 2016, Darlatt entered into a fixed price forward contract to purchase 2,000 tonnes of steel at 400 euros (€) per tonne. The local currency is the dollar (\$). This purchase is in accordance with its normal usage requirements.

The contract allows Darlatt to take delivery of the steel on 31 August 2018 or to pay or receive net settlement in cash, based upon the change in the value of steel but not on the change in the foreign currency exchange rate. Darlatt has not settled similar contracts in the past before delivery of the steel. Darlatt does not have a foreign currency contract to hedge against any risk caused by any movement in the dollar/euro exchange rate and has paid a non-refundable deposit of €100,000 at 1 September 2016. The following exchange rates are relevant:

Date	Exchange rate (euros:dollars)
1 September 2016	2:1
31 August 2017	1·75:1

There had been no change in the contract price of steel at 31 August 2017 and it is felt that the decline in the dollar/euro exchange rate is unlikely to be reversed.

The directors of Darlatt would like to know how to account for the above contract at 31 August 2017 and whether it is within the scope of IFRS 9 *Financial Instruments*, together with any implications of the change in the dollar/euro exchange rate. (7 marks)

Required:

Discuss the advice which should be given to Dalatt in each of the cases with reference to relevant International Financial Reporting Standards.

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

(b) Grail is an SME which has built an offshore wind farm with the purpose of testing the efficiency of its prototype wind turbines. Grail has applied to the regulators for approval for production of its new prototype but has only received permission to test the prototype wind turbine. The wind farm development will enable Grail to test the reliability of the new wind turbines which should assist in developing more efficient and cost effective offshore wind turbines, but as yet there has not been any commercial production of the prototype wind turbines as there is still some doubt over the wind turbines' durability in extreme weather conditions. There is sufficient resource to complete the wind farm project but the energy income has not been included in management's resource planning.

The directors of Grail wish to know how the expenditure on the wind farm would be accounted for under FRS 102 *The Financial Reporting Standard applicable in the UK and the Republic of Ireland* and whether there is any potential difference in the treatment of the measurement of the wind farms under IFRS for SMEs and FRS 102.

Required:

Advise the directors of Grail on the issues raised above. (8 marks)

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

(25 marks)

4 When an entity issues a financial instrument, it has to determine its classification either as debt or as equity. The result of the classification can have a significant effect on the entity's reported results and financial position. An understanding of what an entity views as capital and its strategy for capital management is important to all companies and not just banks and insurance companies. There is diversity in practice as to what different companies see as capital and how it is managed.

Required:

(a) **(i)** **Discuss why the information about the capital of a company is important to investors, setting out the nature of the published information available to investors about a company's capital.**

Note: Your answer should briefly set out the nature of financial capital in integrated reports. (8 marks)

(ii) **Discuss the importance of the classification of equity and liabilities under International Financial Reporting Standards and how this classification has an impact on the information disclosed to users in the statement of profit or loss and other comprehensive income and the statement of financial position.**

(6 marks)

(b) Amster has issued two classes of preference shares. The first class was issued at a fair value of $50 million on 30 November 2017. These shares give the holder the right to a fixed cumulative cash dividend of 8% per annum of the issue price of each preferred share. The company may pay all, part or none of the dividend in respect of each preference share. If the company does not pay the dividend after six months from the due date, then the unpaid amount carries interest at twice the prescribed rate subject to approval of the management committee. The preference shares can be redeemed but only on the approval of the management committee.

The second class of preference shares was issued at a fair value of $25 million and is a non-redeemable preference share. The share has a discretionary annual dividend which is capped at a maximum amount. If the dividend is not paid, then no dividend is payable to the ordinary shareholders. Amster is currently showing both classes of preference shares as liabilities.

On 1 December 2016, Amster granted 250 cash-settled share awards to each of its 1,500 employees on the condition that the employees remain in its employment for the next three years. Cash is payable at the end of three years based on the share price of the entity's shares on that date. During the year to 30 November 2017, 65 employees left and, at that date, Amster estimates that an additional 115 employees will leave during the following two years. The share price at 30 November 2017 is $35 per share and it is anticipated that it will rise to $46 per share by 30 November 2019. Amster has charged the expense to profit or loss and credited equity with the same amount.

The capitalisation table of Amster is set out below:

Amster Group – capitalisation table

	30 November 2017 ($ million)
Long-term liabilities	81
Pension plan deficit	30
Cumulative preference shares	75
Total long-term liabilities	186
Non-controlling interest	10
Shareholders equity	150
Total group equity	160
Total capitalisation	346

Required:

Discuss whether the accounting treatment of the above transactions is acceptable under International Financial Reporting Standards including any adjustment which is required to the capitalisation table and the effect on the gearing and the return on capital employed ratios. (9 marks)

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

(25 marks)

End of Question Paper