THE INDUSTRY QUESTION

RELEVANT TO ACCA QUALIFICATION PAPER P2

This article looks at the techniques required to answer industry questions in Paper P2, *Corporate Reporting*. Even though it is an optional question, it is frequently selected by students and frequently poorly attempted. This is hardly surprising because the question requires analysis and thought, and many students find it difficult to think in this way during an exam.

Nevertheless, many students could perform much better if they tuned in to these questions. This article aims to deliver that tuning by working through an absolute classic industry question from December 2005 called *Ryder*. This question is particularly mixed in that it ranges widely across the syllabus from goodwill to share-based payment.

The most common error students make when answering these questions is to write everything they know about a topic and make no attempt to relate it to the scenario. These questions are not really testing your knowledge. They are testing your ability to apply that knowledge. The best student answers are brilliantly simple, clear and straight to the point. However, the worst student answers are depressingly random knowledge dumps. These latter answers score few marks.

Let us look now at the question *Ryder* from the Paper P2 December 2005 exam. I have adjusted the question very slightly, in particular to strip out the dates in order to make sure the question feels current.

RYDER: THE QUESTION

Ryder, a public limited company, is a large conglomerate operating in manufacturing. Ryder is reviewing certain events which have occurred since its year end of 31 October. The financial statements were authorised on 12 December. The following events are relevant to the financial statements for the year ended 31 October:

a Ryder disposed of a wholly-owned subsidiary, Krup, a limited company, on 10 December after the year end and made a loss of $9m on the transaction in the draft group financial statements. As at the year end of 31 October, Ryder had no intention of selling the subsidiary which was material to the group. The directors of Ryder have stated that no significant events had occurred since 31 October which could have resulted in a reduction in the value of Krup. The carrying value of the net assets and purchased goodwill of Krup at 31 October were $20m and $12m respectively. Krup had made a loss of $2m in the new year period from 1 November to 10 December.

(6 marks)

b Ryder acquired a wholly-owned subsidiary, Metalic, a limited company, on 21 January before the current year start, almost two years ago. The consideration payable in respect of the acquisition of Metalic was 2 million ordinary shares of $1 of Ryder, plus a further 300,000 ordinary shares if the profit of Metalic exceeded $6m for the current year ended 31 October. The profit for the year of Metalic was $7m for the current year and the ordinary shares were issued on 12 November, just after the current year end. The annual profits of Metalic had averaged $7m over the past few years and, therefore, Ryder had included an estimate of the contingent consideration in the cost of the acquisition at acquisition. The fair value used for the ordinary shares of Ryder at this date, including the contingent consideration, was $10 per share. The fair value of the ordinary shares on 12 November at issue after the current year end was $11 per share.

(8 marks)

c The company acquired a property at the current year start, on 1 November, which it intended to sell. The property was obtained as a result of a default on a loan agreement by a third party and was valued at $20m on that date for accounting purposes which exactly offset the defaulted loan. The property was in a state of disrepair and Ryder intended to complete the repairs before it sold the property. The repairs were completed on 30 November after the current year end. The property was sold after costs for $27m on 9 December after the current year end. The property was classified as 'held for sale' at the year end under IFRS 5, *Non-current Assets Held for Sale and Discontinued Operations*, but shown at the net sale proceeds of $27m. Property is depreciated at five per cent per annum on the straight line basis and no depreciation has been charged in the year.

(6 marks)

d The company granted share appreciation rights (SARs) to its employees on 1 November in the prior accounting year, based on 10 million shares. The SARs provide employees, at the date the rights are exercised, with the right to receive cash equal to the appreciation in the company's share price since the grant date. The rights vested at the current year end of 31 October, after two years, and payment was made on schedule on 1 December in the new year. The fair value of the SARs per share at 31 October last year was $6, at 31 October this year was $8, and at 1 December in the new year was $9. The company has recognised a liability for the SARs, as at 31 October past year, based upon IFRS 2, *Share-based Payment*, but the liability was stated at the same amount at 31 October this year in the current financial statements.

(5 marks)

Required

Discuss the accounting treatment of the above events in the current financial statements of the Ryder Group for the year ended 31 October, taking into account the implications of events occurring after the end of the reporting period.

(The mark allocations are set out after each paragraph above)
(Total = 25 marks)

RYDER: THE INITIAL ANALYSIS

Before you do anything, before you even read the requirement, you should look at your watch. You have 45 minutes to answer this question.

Then, before diving into the answer, make sure that you are tuned to the requirement. The usual requirement for the industry question is 'discuss'. This requirement asks us to take into account events occurring after the end of the reporting period. 'Events after the reporting period' (EARP) are sometimes known as 'post-balance sheet events' (PBSE), or even 'subsequent events'. I would suggest we read this requirement as 'discuss, while making at least one reference to EARP for each subscenario'.

Next, you should get a feel for each of the sub-scenarios. Just the briefest scan tells us that Part (b) will be difficult, so we should answer this part last. I have answered in the order of Parts (a), (c), (d) then (b). However, an order of Parts (d), (c), (a) then (b) works equally well.

Once you have settled on an order, you should then divide up the remaining minutes between the parts. The above should only take a couple of minutes, so 1.7 minutes per mark works well.

Then you are off. Here is my answer.

RYDER: MY ANSWER

Part (a) Discontinued

An operation is discontinued if it is closed or sold during the year or held for sale at the year end.

Held for sale

An operation is held for sale if it fulfils the following criteria:

S – sell: there must be an intent at the year end to sell

A – available: the operation must be available for sale at the year end

L – locate: directors must be actively seeking to locate a buyer at the year end

E – expected: the sale must be expected to be completed within 12 months.

Continuing

However, the directors' intent at the year end was to keep the subsidiary; so the subsidiary is continuing.

Events after the reporting period (EARP)

The scenario tells us that nothing happened after the year end to cause the fall in the value of Krup. So the fall in value must have happened before the year end.

Impairment

So this fall in value would give rise to a current year impairment.

Allocation

And the impairment would be allocated to goodwill:

	Before	**Impairment**	**After**
Goodwill	12	(9)	3
Net assets	20		20
	—	—	—
Cash Generating Unit	32	(9)	23
	—	—	—

Provision

The IFRS on provisions prohibits provisions for operating losses. So the $2m is recognised next year.

Part (c) Default

The replacement of the receivable with a property valued at $20m seems to reasonably represent the initial swap.

Held for sale

The property is not 'held for sale' because it is unavailable at the year end because of the repairs.

Non-current assets

So the property has to move back into non-current assets; I suggest as an investment property.

THE MOST COMMON ERROR STUDENTS MAKE WHEN ANSWERING THESE QUESTIONS IS TO WRITE EVERYTHING THEY KNOW ABOUT A TOPIC AND MAKE NO ATTEMPT TO RELATE IT TO THE SCENARIO.

Investment property

I think it is unlikely that the property would be occupied by Ryder given that Ryder did not actually buy the property. Instead, it was acquired as the result of the default on a loan.

Events after the reporting period (EARP)

We can suggest that the property was worth roughly $27m at the year end, given that it was sold for that amount just after the year end.

Investment property accounting

So the following would be recorded:

Opening	20
Gain (balance) (to P/L)	7
	—
Closing (to B/S)	27
	—

Part (d) Share-based payment

The above requires the recognition of an obligation:

Obligation = [number of rights expected to vest] x (fair value) x (timing ratio)

Fair value

Fair value is different depending on the nature of the deal:

Contract	**Settlement**	**Fair value**
Options	Equity	Grant
SARs	Cash	Current

Movement

This contract is SARs, so the following movement in the liability would be recorded:

Opening ($10m)($6)(1/2)	30
Increase (balance)	50
	—
Closing (10m)($8)(2/2)	80
	—

Financial statements

So the obligation would go into current liabilities ($80m) and the increase goes into operating costs ($50m).

Events after the reporting period (EARP)
Actually, this liability is extinguished by the payment of $90m. So the extra $10m might be disclosed as non-adjusting EARP.

Part (b) Goodwill

Goodwill is calculated as follows (for a wholly owned subsidiary):

Fair value of consideration	x
Fair value of net assets	(x)
Goodwill	x

Fair value
Fair value must represent the market value at the time of acquisition. This means that the fair value should be measured based on the information available at acquisition.

Contingent consideration
The inclusion of the contingent consideration of 300,000 shares seems fine. Based on information available at acquisition, it did look like these shares would flow. Back on 21 January, at acquisition, the average profits in the past had exceeded threshold profits ($7m > $6m) and so even at acquisition it looked likely that the criteria would be fulfilled.

Share price
In a similar way, the share price used was fine. The figure of $10 per share was what was available on 21 January at acquisition.

Calculation
So the calculation is as follows:

FV of consideration = ($2m + $0.3m) ($10) = $23m

Hindsight
Notice the $11 share price at issue is hindsight and is irrelevant. Goodwill is not changed for hindsight.

Events after the reporting period (EARP)
The share issue after the year end would be disclosed as non-adjusting EARP.

RYDER: THE ANSWER COMMENTARY
Note the style of my answer. I have used short punchy sentences to deliver each idea and capped each idea with a heading. This answer style is directed specifically at the marking guide for the industry question, which requires that markers award one mark for each point clearly explained.

Also note the style of the language used – simple, clear and direct. I recommend that you resist the temptation to be over-elaborate; you can show how clever you are once you are qualified and sitting in your first board meeting.

Note that my answer does not explain everything. Of course, if you had three weeks and access to a large technical department, then it would be reasonable to expect that you cover all the angles. However, you have 45 minutes, so stick to the big stories and move on quickly.

Note also that my answer does not refer to IFRS numbers. If you know them, stick them in. It all adds to the impression of a competent answer. But my advice would be not to guess. Using the wrong IFRS number is likely to undermine your answer.

Also note that this question, like all industry questions, can be answered in various ways. The examiner's answer is similar to the above, but it is not exactly the same. Indeed, when I answer this question in class, my answer comes out slightly different each time, depending on the comments from students. In the exam, try not to worry about the examiner's answer. Just focus on your answer and make sure it answers the question as set and discusses the issues raised by the scenario.

Finally, my advice would be to practise as many of these questions as you can. Most significantly, the ability to analyse is examined in every Paper P2 exam.

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