

Professional Level – Essentials Module

Corporate Reporting (Malaysia)

Tuesday 9 December 2008

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 (MYS)

The ACCA logo consists of the letters 'ACCA' in a bold, white, sans-serif font, centered within a solid black rectangular background.

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

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

Warrburt Group: Balance Sheet as at 30 November 2008

	30 Nov 2008	30 Nov 2007
	RMm	RMm
Assets		
Non-current assets		
Property, plant and equipment	350	360
Goodwill	80	100
Other intangible assets	228	240
Investment in associate	100	–
Available-for-sale financial assets	142	150
	<u>900</u>	<u>850</u>
Current assets		
Inventories	135	198
Trade receivables	92	163
Cash and cash equivalents	312	323
	<u>539</u>	<u>684</u>
Total assets	<u>1,439</u>	<u>1,534</u>
Equity and Liabilities		
Capital and reserves attributable to equity holders of the company:		
Share capital	650	595
Retained earnings	391	454
Other components of equity	25	20
	<u>1,066</u>	<u>1,069</u>
Minority interests	70	53
Total equity	<u>1,136</u>	<u>1,122</u>
Non-current liabilities:		
Long-term borrowings	20	64
Deferred tax	28	26
Long-term provisions	100	96
Total non-current liabilities	<u>148</u>	<u>186</u>
Current liabilities:		
Trade payables	115	180
Current tax payable	35	42
Short term provisions	5	4
Total current liabilities	<u>155</u>	<u>226</u>
Total liabilities	<u>303</u>	<u>412</u>
Total equity and liabilities	<u>1,439</u>	<u>1,534</u>

Warrburt Group: Income Statement for the year ended 30 November 2008

	RMm
Revenue	910
Cost of sales	(886)
	<hr/>
Gross profit	24
Other income	31
Distribution costs	(40)
Administrative expenses	(35)
Finance costs	(9)
Share of profit of associate	8
	<hr/>
Loss before tax	(21)
Income tax expense	(31)
	<hr/>
Loss for the year from continuing operations	(52)
	<hr/>
Loss for the year	(52)
	<hr/> <hr/>
Statement of recognised income and expense for year ended 30 November 2008 (net of tax):	
Available-for-sale financial assets (AFS)	27
Gains on property revaluation	2
Actuarial losses on defined benefit plan	(4)
	<hr/>
Net income recognised directly in equity	25
Loss for the period	(52)
	<hr/>
Total recognised income and expense for the period	(27)
	<hr/> <hr/>
Attributable to:	
Equity holders of the company	(49)
Minority interest	22
	<hr/>
	(27)
	<hr/> <hr/>

Warrburt Group: Statement of changes in equity for the year ended 30 November 2008

	Share Capital	Retained Earnings	AFS Financial Assets	Revaluation Surplus	Total	Minority Interest	Total Equity
	RMm	RMm	RMm	RMm	RMm	RMm	RMm
Balance at							
1 December 2007	595	454	16	4	1,069	53	1,122
Total recognised income and expenses for the year		(78)	27	2	(49)	22	(27)
Share capital issued	55				55		55
Dividends		(9)			(9)	(5)	(14)
Transfer to retained earnings		24	(24)				
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>
Balance at							
30 November 2008	650	391	19	6	1,066	70	1,136
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>

Note to Statement of changes in equity:

	RMm
Profit/Loss attributable to equity holders of company	(74)
Actuarial losses on defined benefit plan	(4)
	<hr/>
Retained earnings	(78)

The following information relates to the financial statements of Warrburt:

- (i) Warrburt holds available-for-sale (AFS) financial assets which are owned by the holding company. The following schedule relates to those assets.

	RMm
Balance 1 December 2007	150
Less sales of AFS financial assets at carrying value	(38)
Add gain on revaluation of AFS financial assets	30
	<hr/>
	142

The sale proceeds of the AFS financial assets were RM45 million. Profit on the sale of AFS financial assets is shown as 'other income' in the financial statements. Deferred tax of RM3 million arising on the revaluation gain above has been taken into account in 'total recognised income and expenses' for the year. The profit held in equity on the AFS financial assets that were sold of RM24 million, has been transferred to retained earnings.

- (ii) The retirement benefit liability is shown as a long term provision in the Balance Sheet and comprises the following:

	RMm
Liability at 1 December 2007	96
Expense for period	10
Contributions to scheme (paid)	(10)
Actuarial losses	4
	<hr/>
Liability at 30 November 2008	100

Warrburt recognises actuarial gains and losses in the Statement of Recognised Income and Expense in the period in which they occur. The benefits paid in the period by the trustees of the scheme were RM3 million. There is no tax impact with regards to the retirement benefit liability.

- (iii) The property, plant and equipment (PPE) in the Balance Sheet comprises the following:

	RMm
Carrying value at 1 December 2007	360
Additions at cost	78
Gains on property revaluation	4
Disposals	(56)
Depreciation	(36)
	<hr/>
Carrying value at 30 November 2008	350

Plant and machinery with a carrying value of RM1 million had been destroyed by fire in the year. The asset was replaced by the insurance company with new plant and machinery which was valued at RM3 million. The machines were acquired directly by the insurance company and no cash payment was made to Warrburt. The company included the net gain on this transaction in 'additions at cost' and 'other income'.

The disposal proceeds were RM63 million. The gain on disposal is included in administrative expenses. Deferred tax of RM2 million has been deducted in arriving at the 'gains on property revaluation' figure in 'total recognised income and expenses for year'.

The remaining additions of PPE comprised imported plant and equipment from an overseas supplier on 30 June 2008. The cost of the PPE was 380 million dinars with 280 million dinars being paid on 31 October 2008 and the balance to be paid on 31 December 2008.

The rates of exchange were as follows:

	Dinars to RM1
30 June 2008	5
31 October 2008	4.9
30 November 2008	4.8

Exchange gains and losses are included in administrative expenses.

- (iv) Warrburt purchased a 25% interest in an associate for cash on 1 December 2007. The net assets of the associate at the date of acquisition were RM300 million. The associate made a profit after tax of RM24 million and paid a dividend of RM8 million out of these profits in the year ended 30 November 2008. Assume a tax rate of 25%.
- (v) An impairment test had been carried out at 30 November 2008, on goodwill and other intangible assets. The result showed that goodwill was impaired by RM20 million and other intangible assets by RM12 million.
- (vi) The short term provisions relate to finance costs which are payable within six months.

Warrburt's directors are concerned about the results for the year and the subsequent effect on the cash flow statement. They have suggested that the proceeds of the sale of property, plant and equipment and the sale of available-for-sale financial assets should be included in 'cash generated from operations'. The directors are afraid of an adverse market reaction to their results and of the importance of meeting targets in order to ensure job security, and feel that the adjustments for the proceeds would enhance the 'cash health' of the business.

Required:

- (a) **Prepare a group statement of cash flows for Warrburt for the year ended 30 November 2008 in accordance with FRS107, 'Cash Flow Statements', using the indirect method.** (35 marks)
- (b) **Discuss the key issues which the cash flow statement highlights regarding the cash flow of the company.** (10 marks)
- (c) **Discuss the ethical responsibility of the company accountant in ensuring that manipulation of the cash flow statement, such as that suggested by the directors, does not occur.** (5 marks)

Note: requirements (b) and (c) include 2 professional marks in total for the quality of the discussion.

(50 marks)

Section B – TWO questions ONLY to be attempted

- 2 Marrgrett, a public limited company, is currently planning to acquire and sell interests in other entities and has asked for advice on the impact of FRS3 'Business Combinations', FRS 127 'Consolidated and Separate Financial Statements' and any other relevant standards on these plans.

The company is considering purchasing additional shares in an associate, Josey, a public limited company. The holding will increase from 30% stake to 70% stake by offering the shareholders of Josey, cash and shares in Marrgrett. Marrgrett anticipates that it will pay RM5 million in transaction costs to lawyers and bankers including the costs of raising capital for the acquisition. Josey had previously been the subject of a management buyout. In order that the current management shareholders may remain in the business, Marrgrett is going to offer them share options in Josey subject to them remaining in employment for two years after the acquisition. Additionally, Marrgrett will offer the same shareholders shares in the holding company which are contingent upon a certain level of profitability being achieved by Josey. Each shareholder will receive shares of the holding company up to a value of RM50,000, if Josey achieves a pre-determined rate of return on capital employed for the next two years.

Josey has several marketing-related intangible assets that are used primarily in marketing or promotion of its products. These include trade names and internet domain names. These are not currently recognised in Josey's financial statements. Josey operates in a country where depreciation is calculated in accordance with local tax law rather than by reference to the estimated useful life of the non-current assets. Because of its plans to change the overall structure of the business, Marrgrett wishes to recognise a re-organisation provision at the date of the business combination and has assigned provisional values to some of the assets of Josey.

To finance the acquisition of Josey, Marrgrett intends to dispose of a partial interest in two subsidiaries. Marrgrett will retain control of the first subsidiary but will sell the apparent controlling interest in the second subsidiary Wells, a public limited company. Marrgrett decided to dispose of Wells, partially to its management. The group will retain 45% of the ordinary shares, management will have 35% of the ordinary shares and other shareholders will hold 20%. All shareholders will hold share options which are convertible into ordinary shares. The options are held in the same proportion as the ordinary shares. Management's options are only convertible if certain profit targets are met. The remainder are convertible after three years.

Required:

Discuss the principles and nature of the accounting treatment of the above plans under Malaysian Financial Reporting Standards.

Note: this requirement includes 2 professional marks for the quality of the discussion.

(25 marks)

3 Johan, a public limited company, operates in the telecommunications industry. The industry is capital intensive with heavy investment in licences and network infrastructure. Competition in the sector is fierce and technological advances are a characteristic of the industry. Johan has responded to these factors by offering incentives to customers and, in an attempt to acquire and retain them, Johan purchased a telecom licence on 1 December 2006 for RM120 million. The licence has a term of six years and cannot be used until the network assets and infrastructure are ready for use. The related network assets and infrastructure became ready for use on 1 December 2007. Johan could not operate in the country without the licence and is not permitted to sell the licence. Johan expects its subscriber base to grow over the period of the licence but is disappointed with its market share for the year to 30 November 2008. The licence agreement does not deal with the renewal of the licence but there is an expectation that the regulator will grant a single renewal for the same period of time as long as certain criteria regarding network build quality and service quality are met. Johan has no experience of the charge that will be made by the regulator for the renewal but other licences have been renewed at a nominal cost. The licence is currently stated at its original cost of RM120 million in the balance sheet under non-current assets.

Johan is considering extending its network and has carried out a feasibility study during the year to 30 November 2008. The design and planning department of Johan identified five possible geographical areas for the extension of its network. The internal costs of this study were RM150,000 and the external costs were RM100,000 during the year to 30 November 2008. Following the feasibility study, Johan chose a geographical area where it was going to install a base station for the telephone network. The location of the base station was dependent upon getting planning permission. A further independent study has been carried out by third party consultants in an attempt to provide a preferred location in the area, as there is a need for the optimal operation of the network in terms of signal quality and coverage. Johan proposes to build a base station on the recommended site on which planning permission has been obtained. The third party consultants have charged RM50,000 for the study. Additionally Johan has paid RM300,000 as a single payment together with RM60,000 a month to the government of the region for access to the land upon which the base station will be situated. The contract with the government is for a period of 12 years and commenced on 1 November 2008. There is no right of renewal of the contract and legal title to the land remains with the government.

Johan purchases telephone handsets from a manufacturer for RM200 each, and sells the handsets direct to customers for RM150 if they purchase call credit (call card) in advance on what is called a prepaid phone. The costs of selling the handset are estimated at RM1 per set. The customers using a prepaid phone pay RM21 for each call card at the purchase date. Call cards expire six months from the date of first sale. There is an average unused call credit of RM3 per card after six months and the card is activated when sold.

Johan also sells handsets to dealers for RM150 and invoices the dealers for those handsets. The dealer can return the handset up to a service contract being signed by a customer. When the customer signs a service contract, the customer receives the handset free of charge. Johan allows the dealer a commission of RM280 on the connection of a customer and the transaction with the dealer is settled net by a payment of RM130 by Johan to the dealer being the cost of the handset to the dealer (RM150) deducted from the commission (RM280). The handset cannot be sold separately by the dealer and the service contract lasts for a 12 month period. Dealers do not sell prepaid phones, and Johan receives monthly revenue from the service contract.

The chief operating officer, a non-accountant, has asked for an explanation of the accounting principles and practices which should be used to account for the above events.

Required:

Discuss the principles and practices which should be used in the financial year to 30 November 2008 to account for:

- (a) the licences;** (8 marks)
 - (b) the costs incurred in extending the network;** (7 marks)
 - (c) the purchase of handsets and the recognition of revenue from customers and dealers.** (8 marks)
- Appropriateness and quality of discussion. (2 marks)

(25 marks)

4 Whilst acknowledging the importance of high quality corporate reporting, the recommendations to improve it are sometimes questioned on the basis that the marketplace for capital can determine the nature and quality of corporate reporting. It could be argued that additional accounting and disclosure standards would only distort a market mechanism that already works well and would add costs to the reporting mechanism, with no apparent benefit. It could be said that accounting standards create costly, inefficient, and unnecessary regulation. It could be argued that increased disclosure reduces risks and offers a degree of protection to users. However, increased disclosure has several costs to the preparer of financial statements.

Required:

(a) **Explain why accounting standards are needed to help the market mechanism work effectively for the benefit of preparers and users of corporate reports.** (9 marks)

(b) **Discuss the relative costs to the preparer and benefits to the users of financial statements of increased disclosure of information in financial statements.** (14 marks)

Quality of discussion and reasoning. (2 marks)

(25 marks)

End of Question Paper