Professional Level – Essentials Module

Corporate Reporting (International)

Tuesday 11 December 2012

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 (INT)

ACCA

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

1 Minny is a company which operates in the service sector. Minny has business relationships with Bower and Heeny. All three entities are public limited companies. The draft statements of financial position of these entities are as follows at 30 November 2012:

	Minny $m	Bower $m	Heeny $m
Assets:			
Non-current assets			
Property, plant and equipment	920	300	310
Investments in subsidiaries			
Bower	730		
Heeny		320	
Investment in Puttin	48		
Intangible assets	198	30	35
	1,896	650	345
Current assets	895	480	250
Total assets	2,791	1,130	595
Equity and liabilities:			
Share capital	920	400	200
Other components of equity	73	37	25
Retained earnings	895	442	139
Total equity	1,888	879	364
Non-current liabilities	495	123	93
Current liabilities	408	128	138
Total liabilities	903	251	231
Total equity and liabilities	2,791	1,130	595

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

1. On 1 December 2010, Minny acquired 70% of the equity interests of Bower. The purchase consideration comprised cash of $730 million. At acquisition, the fair value of the non-controlling interest in Bower was $295 million. On 1 December 2010, the fair value of the identifiable net assets acquired was $835 million and retained earnings of Bower were $319 million and other components of equity were $27 million. The excess in fair value is due to non-depreciable land.

2. On 1 December 2011, Bower acquired 80% of the equity interests of Heeny for a cash consideration of $320 million. The fair value of a 20% holding of the non-controlling interest was $72 million; a 30% holding was $108 million and a 44% holding was $161 million. At the date of acquisition, the identifiable net assets of Heeny had a fair value of $362 million, retained earnings were $106 million and other components of equity were $20 million. The excess in fair value is due to non-depreciable land.

   It is the group's policy to measure the non-controlling interest at fair value at the date of acquisition.

3. Both Bower and Heeny were impairment tested at 30 November 2012. The recoverable amounts of both cash generating units as stated in the individual financial statements at 30 November 2012 were Bower, $1,425 million, and Heeny, $604 million, respectively. The directors of Minny felt that any impairment of assets was due to the poor performance of the intangible assets. The recoverable amount has been determined without consideration of liabilities which all relate to the financing of operations.

4. Minny acquired a 14% interest in Puttin, a public limited company, on 1 December 2010 for a cash consideration of $18 million. The investment was accounted for under IFRS 9 *Financial Instruments* and was designated as at fair value through other comprehensive income. On 1 June 2012, Minny acquired an additional

16% interest in Puttin for a cash consideration of $27 million and achieved significant influence. The value of the original 14% investment on 1 June 2012 was $21 million. Puttin made profits after tax of $20 million and $30 million for the years to 30 November 2011 and 30 November 2012 respectively. On 30 November 2012, Minny received a dividend from Puttin of $2 million, which has been credited to other components of equity.

5. Minny purchased patents of $10 million to use in a project to develop new products on 1 December 2011. Minny has completed the investigative phase of the project, incurring an additional cost of $7 million and has determined that the product can be developed profitably. An effective and working prototype was created at a cost of $4 million and in order to put the product into a condition for sale, a further $3 million was spent. Finally, marketing costs of $2 million were incurred. All of the above costs are included in the intangible assets of Minny.

6. Minny intends to dispose of a major line of the parent's business operations. At the date the held for sale criteria were met, the carrying amount of the assets and liabilities comprising the line of business were:

	$m
Property, plant and equipment (PPE)	49
Inventory	18
Current liabilities	3

It is anticipated that Minny will realise $30 million for the business. No adjustments have been made in the financial statements in relation to the above decision.

Required:

(a) Prepare the consolidated statement of financial position for the Minny Group as at 30 November 2012.
(35 marks)

(b) Minny intends to dispose of a major line of business in the above scenario and the entity has stated that the held for sale criteria were met under IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*. The criteria in IFRS 5 are very strict and regulators have been known to question entities on the application of the standard. The two criteria which must be met before an asset or disposal group will be defined as recovered principally through sale are: that it must be available for immediate sale in its present condition and the sale must be highly probable.

Required:

Discuss what is meant in IFRS 5 by 'available for immediate sale in its present condition' and 'the sale must be highly probable', setting out briefly why regulators may question entities on the application of the standard. (7 marks)

(c) Bower has a property which has a carrying value of $2 million at 30 November 2012. This property had been revalued at the year end and a revaluation surplus of $400,000 had been recorded in other components of equity. The directors were intending to sell the property to Minny for $1 million shortly after the year end. Bower previously used the historical cost basis for valuing property.

Required:

Without adjusting your answer to part (a), discuss the ethical and accounting implications of the above intended sale of assets to Minny by Bower. (8 marks)

(50 marks)

Section B – TWO questions ONLY to be attempted

2 **(a)** Coate, a public limited company, is a producer of ecologically friendly electrical power (green electricity). Coate's revenue comprises mainly the sale of electricity and green certificates. Coate obtains green certificates under a national government scheme. Green certificates represent the environmental value of green electricity. The national government requires suppliers who do not produce green electricity to purchase a certain number of green certificates. Suppliers who do not produce green electricity can buy green certificates either on the market on which they are traded or directly from a producer such as Coate. The national government wishes to give incentives to producers such as Coate by allowing them to gain extra income in this way.

Coate obtains the certificates from the national government on satisfactory completion of an audit by an independent organisation, which confirms the origin of production. Coate then receives a certain number of green certificates from the national government depending on the volume of green electricity generated. The green certificates are allocated to Coate on a quarterly basis by the national government and Coate can trade the green certificates.

Coate is uncertain as to the accounting treatment of the green certificates in its financial statements for the period ended 30 November 2012 and how to treat the green certificates which were not sold at the end of the reporting period. (7 marks)

(b) During the year ended 30 November 2012, Coate acquired an overseas subsidiary whose financial statements are prepared in a different currency to Coate. The amounts reported in the consolidated statement of cash flows included the effect of changes in foreign exchange rates arising on the retranslation of its overseas operations. Additionally, the group's consolidated statement of cash flows reported as a loss the effect of foreign exchange rate changes on cash and cash equivalents as Coate held some foreign currency of its own denominated in cash. (5 marks)

(c) Coate also sold 50% of a previously wholly owned subsidiary, Patten, to a third party, Manis. Manis is in the same industry as Coate. Coate has continued to account for the investment in Patten as a subsidiary in its consolidated financial statements. The main reason for this accounting treatment was the agreement that had been made with Manis, under which Coate would exercise general control over Patten's operating and financial policies. Coate has appointed three out of four directors to the board. The agreement also stated that certain decisions required consensus by the two shareholders.

Under the shareholder agreement, consensus is required with respect to:

- significant changes in the company's activities;
- plans or budgets that deviate from the business plan;
- accounting policies; acquisition of assets above a certain value; employment or dismissal of senior employees; distribution of dividends or establishment of loan facilities

Coate feels that the consensus required above does not constitute a hindrance to the power to control Patten, as it is customary within the industry to require shareholder consensus for decisions of the types listed in the shareholders' agreement. (6 marks)

(d) In the notes to Coate's financial statements for the year ended 30 November 2012, the tax expense included an amount in respect of 'Adjustments to current tax in respect of prior years' and this expense had been treated as a prior year adjustment. These items related to adjustments arising from tax audits by the authorities in relation to previous reporting periods.

The issues that resulted in the tax audit adjustment were not a breach of tax law but related predominantly to transfer pricing issues, for which there was a range of possible outcomes that were negotiated during 2012 with the taxation authorities. Further at 30 November 2011, Coate had accounted for all known issues arising from the audits to that date and the tax adjustment could not have been foreseen as at 30 November 2011, as the audit authorities changed the scope of the audit. No penalties were expected to be applied by the taxation authorities. (5 marks)

Required:

Discuss how the above events should be accounted for in the individual or, as appropriate, the consolidated financial statements of Coate.

Note: The mark allocation is shown against each of the four events above.

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

(2 marks)

(25 marks)

3 Blackcutt is a local government organisation whose financial statements are prepared using International Financial Reporting Standards.

(a) Blackcutt wishes to create a credible investment property portfolio with a view to determining if any property may be considered surplus to the functional objectives and requirements of the local government organisation. The following portfolio of property is owned by Blackcutt.

Blackcutt owns several plots of land. Some of the land is owned by Blackcutt for capital appreciation and this may be sold at any time in the future. Other plots of land have no current purpose as Blackcutt has not determined whether it will use the land to provide services such as those provided by national parks or for short-term sale in the ordinary course of operations.

The local government organisation supplements its income by buying and selling property. The housing department regularly sells part of its housing inventory in the ordinary course of its operations as a result of changing demographics. Part of the inventory, which is not held for sale, is to provide housing to low-income employees at below market rental. The rent paid by employees covers the cost of maintenance of the property. (7 marks)

(b) Blackcutt has outsourced its waste collection to a private sector provider called Waste and Co and pays an annual amount to Waste and Co for its services. Waste and Co purchases the vehicles and uses them exclusively for Blackcutt's waste collection. The vehicles are painted with the Blackcutt local government organisation name and colours. Blackcutt can use the vehicles and the vehicles are used for waste collection for nearly all of the asset's life. In the event of Waste and Co's business ceasing, Blackcutt can obtain legal title to the vehicles and carry on the waste collection service. (6 marks)

(c) Blackcutt owns a warehouse. Chemco has leased the warehouse from Blackcutt and is using it as a storage facility for chemicals. The national government has announced its intention to enact environmental legislation requiring property owners to accept liability for environmental pollution. As a result, Blackcutt has introduced a hazardous chemical policy and has begun to apply the policy to its properties. Blackcutt has had a report that the chemicals have contaminated the land surrounding the warehouse. Blackcutt has no recourse against Chemco or its insurance company for the clean-up costs of the pollution. At 30 November 2012, it is virtually certain that draft legislation requiring a clean up of land already contaminated will be enacted shortly after the year end. (4 marks)

(d) On 1 December 2006, Blackcutt opened a school at a cost of \$5 million. The estimated useful life of the school was 25 years. On 30 November 2012, the school was closed because numbers using the school declined unexpectedly due to a population shift caused by the closure of a major employer in the area. The school is to be converted for use as a library, and there is no expectation that numbers using the school will increase in the future and thus the building will not be reopened for use as a school. The current replacement cost for a library of equivalent size to the school is \$2·1 million. Because of the nature of the non-current asset, value-in-use and net selling price are unrealistic estimates of the value of the school. The change in use would have no effect on the estimated life of the building. (6 marks)

Required:

Discuss how the above events should be accounted for in the financial statements of Blackcutt.

Note: The mark allocation is shown against each of the four events above.

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

(25 marks)

4 **(a)** The International Accounting Standards Board has recently completed a joint project with the Financial Accounting Standards Board (FASB) on fair value measurement by issuing IFRS 13 *Fair Value Measurement*. IFRS 13 defines fair value, establishes a framework for measuring fair value and requires significant disclosures relating to fair value measurement.

The IASB wanted to enhance the guidance available for assessing fair value in order that users could better gauge the valuation techniques and inputs used to measure fair value. There are no new requirements as to when fair value accounting is required, but the IFRS gives guidance regarding fair value measurements in existing standards. Fair value measurements are categorised into a three-level hierarchy, based on the type of inputs to the valuation techniques used. However, the guidance in IFRS 13 does not apply to transactions dealt with by certain specific standards.

Required:

(i) Discuss the main principles of fair value measurement as set out in IFRS 13. (7 marks)

(ii) Describe the three-level hierarchy for fair value measurements used in IFRS 13. (6 marks)

(b) Jayach, a public limited company, is reviewing the fair valuation of certain assets and liabilities in light of the introduction of IFRS 13.

It carries an asset that is traded in different markets and is uncertain as to which valuation to use. The asset has to be valued at fair value under International Financial Reporting Standards. Jayach currently only buys and sells the asset in the Australasian market. The data relating to the asset are set out below:

Year to 30 November 2012	Asian Market	European Market	Australasian Market
Volume of market – units	4 million	2 million	1 million
Price	$19	$16	$22
Costs of entering the market	$2	$2	$3
Transaction costs	$1	$2	$2

Additionally, Jayach had acquired an entity on 30 November 2012 and is required to fair value a decommissioning liability. The entity has to decommission a mine at the end of its useful life, which is in three years' time. Jayach has determined that it will use a valuation technique to measure the fair value of the liability. If Jayach were allowed to transfer the liability to another market participant, then the following data would be used.

Input	Amount
Labour and material cost	$2 million
Overhead	30% of labour and material cost
Third party mark-up – industry average	20%
Annual inflation rate	5%
Risk adjustment – uncertainty relating to cash flows	6%
Risk-free rate of government bonds	4%
Entity's non-performance risk	2%

Jayach needs advice on how to fair value the liability.

Required:

Discuss, with relevant computations, how Jayach should fair value the above asset and liability under IFRS 13. (10 marks)

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

(25 marks)

End of Question Paper