Mock Two

Corporate Reporting (International)

P2CR-MK2-Z17-Q

Paper P2

Time allowed: 3 hours 15 minutes

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

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Section A – THIS ONE QUESTION IS COMPULSORY AND MUST BE ATTEMPTED

1 Bravado, a public limited company, has acquired two subsidiaries and an associate. The draft statements of financial position are as follows at 31 March 2018:

	Bravado	*Message*	*Mixted*
	$m	$m	$m
Assets:			
Non-current assets			
Property, plant and equipment	265	230	161
Investments in subsidiaries			
Message	300		
Mixted	128		
Investment in associate – Clarity	20		
Other investments	51	6	5
	764	236	166
Current assets:			
Inventories	135	55	73
Trade receivables	91	45	32
Cash and cash equivalents	102	100	8
	328	200	113
Total assets	1,092	436	279
Equity and liabilities:			
Equity share capital ($1)	520	220	100
Retained earnings	240	150	80
Other components of equity	12	4	7
Total equity	772	374	187
Non-current liabilities:			
Long-term borrowings	120	15	5
Deferred tax	25	9	3
Total non-current liabilities	145	24	8
Current liabilities			
Trade and other payables	115	30	60
Current tax payable	60	8	24
Total current liabilities	175	38	84
Total liabilities	320	62	92
Total equity and liabilities	1,092	436	279

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

(i) On 1 April 2017, Bravado acquired 80% of the equity interest of Message, a private company. The purchase consideration comprised cash of $300 million. The fair value of the identifiable net assets of Message was $400 million including any related deferred tax liability arising on acquisition. The owners of Message had to dispose of the company for tax purposes by a specified date and, therefore, agreed a sale with the first company to bid for it, which was Bravado. An independent valuer has stated that the fair value of the non-controlling interest in Message was $86 million on 1 April 2017. Non-controlling interests in subsidiaries are measured at fair value on acquisition. The retained earnings of Message were $136 million and other components of equity were $4 million at the date of acquisition. There had been no new issue of capital by Message since the date of acquisition and the excess of the fair value of the net assets is due to an increase in the value of non-depreciable land.

(ii) On 1 April 2016, Bravado acquired 6% of the equity interests of Mixted. Bravado had treated this investment as at fair value through other comprehensive income in the financial statements to 31 March 2017 but had restated the investment at cost on Mixted becoming a subsidiary. On 1 April 2017, Bravado acquired a further 64% of the equity interests of Mixted and gained control of the company. The consideration for the acquisitions was as follows:

	Holding	*Consideration*
		$m
1 April 2016	6%	10
1 April 2017	64%	118
	70%	128

Under the purchase agreement of 1 April 2017, Bravado is required to pay the former shareholders 30% of the profits of Mixted on 31 March 2019 for each of the financial years to 31 March 2018 and 31 March 2019. The fair value of this arrangement was estimated at $12 million at 1 April 2017 and at 31 March 2018 the fair value had increased to $13 million. This amount has not been included in the financial statements.

At 1 April 2017, the fair value of the equity interest in Mixted held by Bravado before the business combination was $15 million and the fair value of the non-controlling interest in Mixted was $53 million. The fair value of the identifiable net assets (excluding deferred tax assets and liabilities) at 1 April 2017 of Mixted was $170 million, and the retained earnings and other components of equity were $55 million and $7 million respectively. There had been no new issue of share capital by Mixted since the date of acquisition and the excess of the fair value of the net assets is due to an increase in the value of property, plant and equipment.

The fair value of the property, plant and equipment was provisional pending receipt of the final valuations for these assets. These valuations were received on 1 October 2017 and they resulted in a further increase of $6 million in the fair value of the net assets at the date of acquisition. This increase does not affect the fair value of the non-controlling interest. Property, plant and equipment are depreciated on the straight-line basis over seven years. The tax base of the identifiable net assets of Mixted was $166 million at 1 April 2017. The tax rate of Mixted is 30%.

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(iii) Bravado acquired a 10% interest in Clarity, a public limited company, on 1 April 2016 for $8 million. The investment was accounted for as a fair value through other comprehensive income investment and at 31 March 2017, its value was $9 million. On 1 April 2017, Bravado acquired an additional 15% interest in Clarity for $11 million and achieved significant influence. Clarity made profits after dividends of $6 million and $10 million for the years to 31 March 2017 and 31 March 2018.

(iv) On 1 April 2016, Bravado purchased an equity instrument of 11 million dinars which was its fair value. The instrument was classified as a fair value through profit or loss instrument and is included in other investments. The relevant exchange rates and fair values were as follows:

	$ per Dinar	*Fair value of instrument* Dinars million
1 April 2016	4·5	11
31 March 2017	5·1	10
31 March 2018	4·8	7

Bravado has not recorded any change in the value of the instrument since 31 March 2017.

(v) Bravado manufactures equipment for the retail industry. The inventory is currently valued at cost. There is a market for the part completed product at each stage of production. The cost structure of the equipment is as follows:

	Cost per unit $	*Selling price per unit* $
Production process – 1st stage	1,000	1,050
Conversion costs – 2nd stage	500	
Finished product	1,500	1,700

The selling costs are $10 per unit and Bravado has 100,000 units at the first stage of production and 200,000 units of the finished product at 31 March 2018. Shortly before the year end, a competitor released a new model onto the market which caused the equipment manufactured by Bravado to become less attractive to customers. The result was a reduction in the selling price to $1,450 of the finished product and $950 for 1st stage product.

(vi) The directors have included a loan to a director of Bravado in cash and cash equivalents of $1 million. The loan has no specific repayment date but is repayable on demand. The directors feel that there is no problem with this accounting treatment as there is a choice of accounting policy in International Financial Reporting Standards.

(vii) There is no impairment of goodwill arising on the acquisitions.

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Required:

(a) **Prepare a consolidated statement of financial position as at 31 March 2018 for the Bravado Group.** (35 marks)

Note: Calculations and working need only be made to the nearest $100,000.

(b) **Calculate and explain the impact on the calculation of goodwill if the non-controlling interest was calculated as a proportion of the identifiable net assets for Message and Mixted.** (8 marks)

(c) **Discuss the directors' view that there is no problem with showing a loan to a director as cash and cash equivalents, taking into account their ethical and other responsibilities as directors of the company.** (7 marks)

(50 marks)

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Section B – TWO questions ONLY to be attempted

2 Argent, a public limited company, operates in the energy and power sector. The company has experienced significant growth in recent years and has expanded its operations internationally by the acquisition of overseas subsidiaries. Group policy is to translate the financial statements of these subsidiaries using the closing rate method with goodwill calculated at the rate of exchange ruling at the date of acquisition. One of these subsidiaries, Argon, is incorporated in a country, where it is quite difficult to repatriate funds from the country. Argent owns 91% of the shares of Argon with the foreign government owning the balance. Most of the products produced by Argon are sold locally but approximately 10% of the products are sold at cost to Argent. Because of a dispute, Argon has made an allowance for irrecoverability of the inter-group amount owing from Argent. As part of its risk management policies, Argent hedges the profits made by Argon and denominates Argon's financial statements in US dollars rather than local currency. Argon's non-current assets are carried at a US dollar valuation which is prepared by the chief accountant.

The group values its remaining properties independently on the basis of "existing use value", which is essentially current value. The directors have currently opted for a policy of revaluation in the financial statements with the annual transfer of the depreciation on the revalued amount from revaluation reserve to accumulated reserves. Local GAAP requires a full valuation every three years with gains and losses taken to income when the asset is available for sale.

Argent and its subsidiaries have a number of energy trading contracts where energy is bought and sold at a profit. The purchases of energy are currently treated as non-current assets and depreciated over the contract's life, which can be up to 20 years. Revenue recognised on the contracts is 30% on acceptance of the contract with the balance recognised on a straight line basis over the remaining life of the contract, which again could be up to 20 years.

In order to fund the expansion overseas, Argent issued 20 million 3% redeemable preference shares of $1 at nominal value. The preference shares are redeemable in two years' time at a premium of 20% and are shown in the statement of financial position as share capital. A proposed dividend of $0.10 per equity share for the year ended 31 March 2018 has not been approved. The dividend has been shown in the statement of profit or loss and other comprehensive income together with the basic earnings per share and earnings per share before interest, tax, depreciation and amortisation.

The directors of Argent use various derivative financial instruments such as forward contracts to hedge their activities. Wherever possible the company tries to offset its foreign exchange and interest rate risks. Derivative instruments are not recognised in the statement of financial position.

The directors of Argent have been informed that all local listed companies will be required to change the basis on which they prepare their financial reports and prepare their consolidated financial statements in accordance with the financial reporting standards of the International Accounting Standards Board (IASB).

Required:

Discuss the implications for the Argent Group financial statements of a move from using local GAAP to using the financial reporting standards of the IASB. (23 marks)

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

(25 marks)

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3 Wader, a public limited company, is assessing the accounting treatment of certain transactions for the year ended 31 March 2018. The following information is relevant:

(a) On 1 April 2016, Wader had granted share appreciation rights to 200 senior executives. Each executive will receive 2,000 rights on 31 March 2019 if still employed by Wader at that date. On 1 April 2016, the directors estimated that all the executives would remain employed by Wader for the three-year period ending on 31 March 2019. However, 10 executives left in the year ended 31 March 2017 and at 31 March 2017 the directors believed that a further 10 executives would leave in the following two years. Five executives actually left in the year ended 31 March 2018 and the directors now believe that seven more directors will leave in the year ended 31 March 2019. Since 1 April 2016, the fair value of the share appreciation rights has fluctuated as follows:

Date	*Fair value of one right*
	$
1 April 2016	1·60
31 March 2017	1·80
31 March 2018	1·74

(7 marks)

(b) Wader has entered into a contract to manufacture and supply car seats to Vehiclex. This contract will last for five years and Wader will manufacture seats to a certain specification which will require the construction of machinery for the purpose. The price of each car seat has been agreed so that it includes an amount to cover the cost of constructing the machinery but there is no commitment to a minimum order of seats to guarantee the recovery of the costs of constructing the machinery. Wader retains the ownership of the machinery and wishes to recognise part of the revenue from the contract in its current financial statements to cover the cost of the machinery which will be constructed over the next year. (5 marks)

(c) Wader is reviewing the accounting treatment of its buildings. The company uses the revaluation model for its buildings. The buildings had originally cost $10 million on 1 April 2016 and had a useful economic life of 20 years. They are being depreciated on a straight line basis to a nil residual value. The buildings were revalued downwards on 31 March 2017 to $8 million which was the buildings' recoverable amount. At 31 March 2018 the value of the buildings had risen to $11 million which is to be included in the financial statements. The company is unsure how to treat the above events. (6 marks)

(d) Wader has decided to close one of its overseas branches. A board meeting was held on 28 February 2018 when a detailed formal plan was presented to the board. The plan was formalised and accepted at that meeting. Letters were sent out to customers, suppliers and workers on 15 March 2018 and meetings were held prior to the year end to determine the issues involved in the closure. The plan is to be implemented in April 2018. The company wants to provide $8 million for the restructuring but is unsure whether this is permissible. One contract with a supplier stated that Wader must purchase a minimum of $1.5 million of goods each year for the two years ending 31 March 2019 and 2020. Wader has been in contact with the supplier and they have stated they can cancel the contract for a one off payment of $2.4 million on 31 March 2018. The company needs advice on how to treat the above under IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.

(5 marks)

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Required:

Discuss the accounting treatments of the above items in the financial statements for the year ended 31 March 2018.

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

Note: A discount rate of 5% should be used where necessary. Candidates should show suitable calculations where necessary.

(25 marks)

4 Financial statements have seen an increasing move towards the use of fair values in accounting. Advocates of "fair value accounting" believe that fair value is the most relevant measure for financial reporting whilst others believe that historical cost provides a more useful measure.

Issues have been raised over the reliability and measurement of fair values, and over the nature of the current level of disclosure in financial statements in this area.

Required:

(a) **Discuss the problems associated with the reliability and measurement of fair values and the nature of any additional disclosures which may be required if fair value accounting is to be used exclusively in corporate reporting.** (11 marks)

(b) Braymac, a multinational company, has diverse business operations. The following transactions are to be measured at fair value in the financial statements for year ending 31 March 2018:

(i) A decommissioning liability which Braymac is legally required to pay when it closes down and landscapes a quarry in 12 years' time. (3 marks)

(ii) Share options issued to the directors of the company. (3 marks)

(iii) The purchase of 10,000 equity shares in another company, which will give Braymac a 2% holding in the company. (3 marks)

(iv) Lambs born in Braymac's sheep farm during the year. (3 marks)

Required:

Discuss the issues Braymac should take into account when measuring each of the above transactions at fair value. (12 marks)

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

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

(25 marks)

End of Question Paper

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