Strategic Professional – Essentials

Strategic Business Reporting – International (SBR – INT)

Thursday 5 March 2020

SBR INT ACCA EN

Time allowed: 3 hours 15 minutes

This question paper is divided into two sections:

Section A – BOTH questions are compulsory and MUST be attempted

Section B – BOTH questions are compulsory and MUST be attempted

Do NOT open this question paper until instructed by the supervisor.

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

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Think Ahead ACCA

The Association of Chartered Certified Accountants

Section A – BOTH questions are compulsory and MUST be attempted

1 Background

Hummings Co is the parent company of a multinational listed group of companies. Hummings Co uses the dollar ($) as its functional currency. Hummings Co acquired 80% of the equity shares of Crotchet Co on 1 January 20X4 and 100% of Quaver Co on the same date. The group's current financial year end is 31 December 20X4.

Crotchet Co: functional currency

The head office of Crotchet Co is located in a country which uses the dinar as its main currency. However, its staff are located in a variety of other locations. Consequently, half of their employees are paid in dinars and the other half are paid in the currency of grommits. Crotchet Co has a high degree of autonomy and is not reliant on finance from Hummings Co, nor do sales to Hummings Co make up a significant proportion of their income. All of its sales and purchases are invoiced in grommits and therefore Crotchet Co raises most of its finance in grommits. Cash receipts are retained in both grommits and dinars. Crotchet Co does not own a dollar ($) bank account. Crotchet Co is required by law to pay tax on its profits in dinars.

The acquisition of Crotchet Co

Hummings Co paid cash of $24 million for the 80% holding in Crotchet Co on 1 January 20X4. Hummings Co has a policy of measuring non-controlling interests at fair value. The fair value of the non-controlling interests in Crotchet Co on 1 January 20X4 was $6 million. Since Crotchet Co has a range of net assets held domestically and overseas, the fair values of the net assets at acquisition were determined in their local currency. Hence, the fair value of some assets have been determined in dinars and others in grommits. The total fair value of the net assets denominated in grommits at 1 January 20X4 was 43 million grommits. The total fair value of the net assets denominated in dinars at 1 January 20X4 was 50 million dinars.

Excluded from these fair values are several contracts with the customers of Crotchet Co. These contractual relationships prohibit the customers of Crotchet Co from obtaining services from any of the main competitors of Crotchet Co. They have an estimated fair value at 1 January 20X4 of 15 million grommits.

At 31 December 20X4, it was decided to impair goodwill by 30%.

The following is a summary of the exchange rates between the dollar, grommits and dinars at 1 January 20X4 and 31 December 20X4:

1 January 20X4	31 December 20X4
$1:8 grommits	$1:7 grommits
$1:4 dinar	$1:3·5 dinar
1 dinar:2 grommits	1 dinar:2 grommits

The acquisition of Quaver Co

On 1 January 20X4, Hummings Co purchased a 100% equity interest in Quaver Co. Hummings Co made the acquisition with the intention to sell and therefore did not wish to have an active involvement in the business of Quaver Co. Hummings Co immediately began to seek a buyer for Quaver Co and felt that the sale would be completed by 31 October 20X4 at the latest. A buyer for Quaver Co was located in August 20X4 but, due to an unforeseen legal dispute over a contingent liability disclosed in Quaver Co's financial statements, the sale had not yet been finalised as at 31 December 20X4. The sale is expected to be completed in early 20X5.

Impairment of bonds

On 31 December 20X3, Hummings Co purchased $10 million 5% bonds in Stave Co at par value. The bonds are repayable on 31 December 20X6 and the effective rate of interest is 8%. Hummings Co's business model is to collect the contractual cash flows over the life of the asset. At 31 December 20X3, the bonds were considered to be low risk and as a result the 12-month expected credit losses are expected to be $10,000.

On 31 December 20X4, Stave Co paid the coupon interest, however, at that date the risks associated with the bonds were deemed to have increased significantly. The present value of the repayments for the year ended 31 December 20X5 were estimated to be $462,963 and the probability of default is 3%. At 31 December 20X4, it is also anticipated that no further coupon payments would be received during the year ended 31 December 20X6 and only a portion of the nominal value of the bonds would be repaid. The present value of these cash shortfalls was assessed to be $6,858,710 with a 5% likelihood of default in the year ended 31 December 20X6.

Required:

Draft an explanatory note to the directors of Hummings Co, addressing the following:

(a) **how the functional currency of Crotchet Co should be determined;** (5 marks)

(b) (i) **how Crotchet Co's customer contracts should be accounted for in the consolidated financial statements of Hummings Co, which are presented in dollars ($), for the year ended 31 December 20X4;** (4 marks)

(ii) **a calculation of the goodwill on acquisition of Crotchet Co (in grommits) and how it would be accounted for in the consolidated statement of financial position of Hummings Co at 31 December 20X4 after translation. Include a brief explanation and calculation of how the impairment and exchange difference on goodwill will impact on the consolidated financial statements;** (6 marks)

(c) **how Quaver Co should be accounted for in the consolidated financial statements at 31 December 20X4; and** (4 marks)

(d) **a calculation and discussion of how the bonds should be accounted for in the financial statements of Hummings Co as at 31 December 20X3 and for the year ended 31 December 20X4, including any impairment losses.** (11 marks)

(30 marks)

2 Background

Bagshot Co has a controlling interest in a number of entities. Group results have been disappointing in recent years and the directors of Bagshot Co have been discussing various strategies to improve group performance. The current financial year end is 31 December 20X5.

The following personnel are relevant to the scenario:

Mr Shaw	Head accountant of Bagshot Co
Mrs Dawes	Chief executive of Bagshot Co
Mike Starr	Nephew of Mr Shaw
Mrs Shaw	Wife of Mr Shaw

Group restructure

Mr Shaw, an ACCA member, is the head accountant of Bagshot Co. He is not a member of the board of directors. Mrs Dawes, the chief executive of Bagshot Co, is also an ACCA member. During December 20X5, Mrs Dawes revealed plans to Mr Shaw of a potential restructure of the Bagshot group which had been discussed at board meetings. The restructuring plans included a general analysis of expected costs which would be incurred should the restructure take place. These include legal fees, relocation costs for staff and also redundancy costs for a number of employees. One such employee to be made redundant, Mike Starr, is the nephew of Mr Shaw.

Mrs Dawes is insistent that Mr Shaw should include a restructuring provision for all of the expenditure in the financial statements of Bagshot Co for the year ended 31 December 20X5. Mrs Dawes argues that, even if the restructure did not take place exactly as detailed, similar levels of expenditure are likely to be incurred on alternative strategies. It would therefore be prudent to include a restructuring provision for all expenditure. None of the staff other than Mr Shaw have been notified of the plans although Mrs Dawes has informed Mr Shaw that she expects a final decision and public announcement to be made prior to the authorisation of the financial statements.

Mrs Shaw

Mrs Shaw is the wife of Mr Shaw, the head accountant of Bagshot Co. She is not an employee of Bagshot Co and does not know about the proposed restructure. However, Mrs Shaw recently acquired 5% of the equity shares in Bagshot Co. Mr Shaw is considering informing his wife of the proposed restructure so that she can make an informed decision as to whether to divest her shareholding or not. Mr Shaw is concerned that, in the short term at least, the inclusion of any restructuring costs would be harmful to the profitability of Bagshot Co. It is also uncertain as to how the market may react should the restructure take place. It is, however, anticipated that in the long term, shareholder value would be enhanced.

Required:

(a) (i) **Discuss the appropriate accounting treatment of the restructuring costs in the financial statements of Bagshot Co for the year ended 31 December 20X5.** (6 marks)

(ii) **Discuss what is meant by good stewardship of a company and whether the restructure and the recognition of a restructuring provision in the financial statements are examples of good stewardship.** (4 marks)

(iii) **Discuss briefly whether Mrs Shaw's acquisition of the equity shares in Bagshot Co should be disclosed as a related party transaction.** (3 marks)

(b) **Identify and discuss the ethical issues arising from the scenario which Mr Shaw needs to consider and what actions he should take as a consequence.** (5 marks)

Professional marks will be awarded in part (b) for the clarity of discussion. (2 marks)

(20 marks)

Section B – BOTH questions are compulsory and MUST be attempted

3 Background

Leria Co is an internationally successful football club. Leria Co is preparing the financial statements for the year ending 31 October 20X5 but is currently facing liquidity problems.

Stadium sale/leaseback and improvements

Leria Co has entered into a contract regarding its stadium whereby it will sell the stadium on 30 November 20X6 and immediately lease it back. The directors of Leria Co wish to classify the stadium as a non-current asset 'held for sale' in its financial statements for the year ended 31 October 20X5 as they believe the sale to be highly probable at that date. The sale contract requires the disposal of the stadium for its fair value (market value) of $30 million and for Leria Co to lease it back over 10 years. The present value of the lease payments at market rates on 30 November 20X6 will be $26 million. The market value for a stadium of this type has not changed in several years and is unlikely to change in the near future. The stadium is being depreciated by 5% per annum using the reducing balance method.

In the year to 31 October 20X6, it is anticipated that $2 million will be spent to improve the crowd barriers in the stadium. There is no legal requirement to improve the crowd barriers. Leria Co has incorrectly treated this amount as a reduction of the asset's carrying amount at 31 October 20X5 and the corresponding debit has been made to profit or loss. At 31 October 20X5, the carrying amount of the stadium, after depreciation and deduction of the crowd barrier improvements, is $18 million.

Television programme content rights

Leria Co has its own subscription-based television station. As a result, it has material intangible assets which relate to the content rights associated with the television programmes. The budgeted costs of production are based on the estimated future revenues for the television programme. These costs of production are then capitalised as an intangible asset and called 'contents rights'. The directors of Leria Co believe that the intellectual property in the content rights is consumed as customers view the television programmes. Consequently, Leria Co currently amortises the content rights based upon estimated future revenues from the television programme. For example, if a television programme is expected to generate $8 million of revenue in total and $4 million of that revenue is generated in year 1, then the intangible asset will be amortised by 50% in year 1. However, the industry practice is to amortise the capitalised cost of the programme, less its recoverable amount, over its remaining useful life.

Players' contract costs

Players' registration contract costs are shown as intangible assets and are initially recognised at the fair value of the consideration paid for their acquisition. However, subsequently, players' contracts are often re-negotiated at a cost. Also, players' contracts may contain contingent performance conditions where individual players may be paid a bonus based on their success in terms of goals scored or the success of the football team as a whole. These bonuses represent additional contract costs.

For impairment purposes, Leria Co does not consider that it is possible to determine the value-in-use of an individual player unless the player were to suffer a career threatening injury and cannot play in the team. Players only generate direct cash flows when they are sold to another football club.

Required:

(a) Discuss with reference to International Financial Reporting Standards (IFRS®):

(i) whether the directors can classify the stadium as held for sale at 31 October 20X5;

(ii) Leria Co's accounting treatment of the crowd barrier improvements at 31 October 20X5; and

(iii) the principles of the accounting treatment for the sale and leaseback of the stadium at 30 November 20X6. (13 marks)

(b) Discuss:

(i) whether the amortisation of the intangible assets relating to television programme content rights by Leria Co and by the industry are acceptable policies in accordance with IFRS standards; and

(ii) how to account for the players' contract costs (including the contingent performance conditions), any impairment which might be required to these non-current assets and whether a player can be considered a single cash generating unit. (12 marks)

(25 marks)

4 (a) The current developments in sustainability reporting show that there is a global trend towards more extensive and more meaningful narrative reporting. The improvements in the quality and scope of reporting are driven by both regulatory demands and market demands for transparency. 'Sustainable investing' describes an approach to investment where environmental, social or governance (ESG) factors, in combination with financial considerations, guide the selection and management of investments.

Required:

Discuss why the disclosure of sustainable information has become an important and influential consideration for investors. (8 marks)

(b) Background

The directors of Ecoma Co consider environmental, social and governance issues to be extremely important in a wide range of areas, including new product development, reputation building and overall corporate strategy. The company is taking a proactive approach to managing sustainability and is actively seeking opportunities to invest in sustainable projects and embed them in their business practices. The company's financial year end is 30 September 20X5.

Head office

Ecoma Co is committed to a plan to move its head office to a building which has an energy efficient green roof that acts as a natural temperature controller. The move from the current head office, which is leased, will take place at the company's year end of 30 September 20X5. The new green roof building requires less maintenance than a conventional building and produces oxygen which offsets Ecoma Co's CO_2 emissions. The directors of Ecoma Co believe that the green roof building will save the company \$2 million per annum over the useful life of the building. However, over the next two years, it anticipates that the disruption of the move will cause the company to make a loss of \$10 million per annum. The company wishes to make a provision of \$16 million which comprises the loss to be incurred over the next two years net of the saving created by the green roof.

Meanwhile, the company will have to vacate its currently leased head office building. At 30 September 20X5, the lease has two years to run at a rental of \$600,000 per annum payable in advance on 1 October each year. If the lease is cancelled, the full rental is payable on cancellation. The head-lease permits sub-letting and Ecoma Co has sub-let the building for one year from 1 October 20X5 at a rental of \$400,000 per annum payable in advance. Ecoma Co estimates that there is a 40% probability that it will be able to extend the sub-lease at the same rental for a second year.

The costs of moving to the green building are estimated at \$1 million and the costs of terminating the lease in two years' time are negligible. The pre-tax discount rate is 5%.

Defined benefit pension scheme

Ecoma Co is worried that the poor remuneration package offered to employees is putting the company at risk of reputational damage. Consequently, Ecoma Co changed its pension scheme on 30 September 20X5 to include all of its staff. The benefits accrue from the date of their employment but only vest after two years additional service from 30 September 20X5. The net pension obligation at 30 September 20X5 of \$78 million has been updated to include this change. During the year, benefits of \$6 million were paid under the scheme and Ecoma Co contributed \$10 million to the scheme. These payments had been recorded in the financial statements. The following information relates to the pension scheme:

	$m
Net pension obligation at 30 September 20X5	78
Net pension obligation at 30 September 20X4	59
Service cost for year	18
Past service cost relating to scheme amendment at 30 September 20X5	9
Discount rate at 30 September 20X4	5·5%
Discount rate at 30 September 20X5	5·9%

Required:

(i) **Discuss how the $16 million provision associated with Ecoma Co's move to a new head office and the sub-let of its old head office should be accounted for in accordance with IAS® 37 *Provisions, Contingent Liabilities and Contingent Assets*.** (6 marks)

(ii) **Advise Ecoma Co on the principles of accounting for the pension scheme, including calculations, for the year to 30 September 20X5.** (7 marks)

(iii) **Calculate the impact which the above adjustments in (b)(i) and (ii) will have on profit before tax of $25 million for the year ended 30 September 20X5. Ignore any potential tax implications.** (2 marks)

Professional marks will be awarded in part (a) for clarity and quality of discussion. (2 marks)

(25 marks)

End of Question Paper