Strategic Professional – Essentials

Strategic Business Reporting – International (SBR – INT)

September/December 2020 – Sample Questions

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.

SBR – INT

Think Ahead ACCA

The Association of Chartered Certified Accountants

Section A – BOTH questions are compulsory and MUST be attempted

1 At 30 June 20X7, Sugar Co has investments in several associate companies, including Flour Co. On 1 July 20X7 Sugar Co acquired additional shares in Flour Co and obtained control. On 1 October 20X7 Sugar Co also acquired an associate, Butter Co. The group is preparing the consolidated statement of cash flows for the year ended 30 June 20X8.

Acquisition of Flour Co

A 40% shareholding in Flour Co was purchased several years ago at a cost of $10 million. This investment gave Sugar Co significant influence in Flour Co. The consideration to acquire an additional three million shares (30% shareholding) in Flour Co on 1 July 20X7 was in two parts: (i) cash and; (ii) a one for two share exchange when the market price of Sugar Co shares was $6 each. In Flour Co's individual financial statements, the net assets had increased by $12 million between the two acquisition dates. The carrying amount of Flour Co's net assets on 1 July 20X7 was as follows:

	$'000
Intangible assets (licences and patents)	6,781
Property, plant and equipment	18,076
Cash and cash equivalents	1,234
Other net current assets	9,650
Total net assets carrying amount	35,741

The carrying amounts of the net assets at 1 July 20X7 were equal to the fair values except for land which had a fair value $600,000 above the carrying amount. The Sugar group values non-controlling interests (NCI) at fair value and the share price of Flour Co at 1 July 20X7 was $3·80. This share price should be used to value NCI at that date and to value the initial 40% equity interest in Flour Co.

Goodwill at 1 July 20X7 was correctly calculated as $2,259,000 and has been correctly accounted for in the consolidated statement of financial position.

Asset acquisitions and disposals

Including its purchase of the additional investment in Flour Co which it correctly consolidated from 1 July 20X7, the Sugar group also purchased various assets during the year.

There were no disposals or impairments of intangible assets during the year but amortisation of $3·5 million had been deducted from profit from operations.

The only additions to property, plant and equipment during the year were as a result of the acquisition of Flour Co. The group disposed of some plant and machinery at a loss on disposal of $2 million. Depreciation deducted from the profit from operations was $10 million.

Sugar Co purchased a 25% equity interest in Butter Co on 1 October 20X7 for $5 million cash which gave significant influence. Butter Co paid a dividend in the post-acquisition period and Sugar Co also received dividends from other associates during the year ended 30 June 20X8. Sugar Co did not pay any dividends during the year.

There were no acquisitions of investments measured at fair value through profit or loss (FVTPL) during the year but there were disposals which had a carrying amount of $4 million. These were sold at a profit of $500,000 which was included, alongside fair value gains, in investment income in the consolidated statement of profit or loss. The investment income figure also includes dividends received from these investments and any fair value gains or losses recognised on the initial investment in Flour Co.

In addition to the shares issued to purchase Flour Co, Sugar Co issued some ordinary $1 shares for cash during the year ended 30 June 20X8.

Group financial statement extracts

The group's consolidated financial statements have been calculated correctly. Extracts, together with relevant comparative figures at 30 June are provided below:

Consolidated statement of financial position as at 30 June (extracts):

	20X8	20X7
	$'000	$'000
Non-current assets		
Intangible assets	33,456	15,865
Property, Plant and Equipment	55,124	52,818
Investment in Associates	26,328	23,194
Financial assets (measured at FVTPL)	3,000	6,000
Equity		
Ordinary share capital ($1 shares)	23,000	20,000
Other Components of equity (all share premium)	33,600	18,000
Non-controlling interest	30,152	12,914

Consolidated statement of profit or loss for the year ended 30 June 20X8 (extract):

	$'000
Investment income	3,891
Share of profit from associate companies	15,187
Profit attributable to the non-controlling interest	9,162

Pension scheme

Sugar Co is the only entity of the group which operates a defined benefit pension scheme. The pension scheme obligation increased during the year from $1·175m to $6·368m. The movement on the pension liability represents the service cost component, the net interest component and also the remeasurement component for the year. Sugar Co usually makes cash contributions into the scheme on an annual basis towards the year end. The significant increase in the pension scheme obligation for the year ended 30 June 20X8 was because the contributions to the scheme did not follow normal practice and were instead made in July 20X8. Benefits paid during the year were $2 million in cash.

Required:

(a) Draft an explanatory note to the directors of Sugar Co, addressing how the initial 40% investment in Flour Co and the additional purchase of the equity shares on 1 July 20X7 should be accounted for in the consolidated financial statements (including the statement of cash flows). Using the goodwill figure of $2,259,000, calculate the cash paid to acquire control of Flour Co and include a brief explanation as to how that cash should be accounted for in the consolidated statement of cash flows. (10 marks)

(b) Prepare extracts of the cash flows generated from (i) investing activities and (ii) financing activities in the consolidated statement of cash flows for the Sugar group for the year ended 30 June 20X8. No explanations are required in part (b). (16 marks)

(c) Describe the impact, if any, that the defined benefit pension scheme will have on the consolidated statement of cash flows for the Sugar group for the year ended 30 June 20X8 assuming that cash flows from operating activities are calculated by the indirect method. (4 marks)

(30 marks)

2 Calibra Co operates in the property sector and has invested in new technology, distributed ledgers/blockchain, to trade and to support property transactions. The financial year end of Calibra Co is 31 December 20X8.

Apartment blocks

Calibra Co builds apartment blocks which normally take two years to complete from the date of signing the contract. The title and possession, and therefore control, of the apartment blocks pass to the customer upon completion of construction. The price which is payable on completion of each apartment block is $9·55 million. Alternatively, customers can pay $8·5 million cash on the day that the contract is signed. The chief accountant has calculated that this represents an appropriate borrowing rate of 6% for Calibra Co. Calibra Co immediately recognises $8·5 million as revenue if customers pay when they sign the contract.

Chief accountant and Bodoni Co

The chief accountant does not hold a permanent employment contract with Calibra Co. He has applied for the position on a permanent basis and is to be interviewed in the near future. Bodoni Co, a customer of Calibra Co, wanted to take advantage of the $8·5 million reduced price for an apartment block but was having problems with cash flow. The chief accountant therefore allowed Bodoni Co to pay $8·5 million and to delay payment until one month after the contract was signed. In return, Bodoni Co has agreed to provide a good employment reference. The chief accountant of Calibra Co was afraid that he might lose Bodini Co as a customer and referee if he did not agree to the delay in payment.

Distributed ledger technology

Calibra Co has recently used distributed ledger technology/blockchain to sell shares in a property to investors. These digitised transactions are only visible to the authorised parties. The chief accountant publicly supports this technology and is to manage the new system. However, he has private concerns over the reliability of the due diligence carried out on the sale of property shares and the potential violation of local regulations. The directors of Calibra Co want to increase the number of transactions on the distributed ledger by offering digital shares in the whole of the entity's property portfolio. Although the chief accountant has very basic knowledge of distributed ledgers, he has assured the directors that he can facilitate this move. The project has been approved by the board despite the chief accountant's private reservations. The chief accountant has only recently qualified as an accountant and wishes to be employed with Calibra Co on a permanent basis.

Required:

(a) Discuss how Calibra Co should have accounted for the sale of the apartment blocks in accordance with IFRS 15 *Revenue from Contracts with Customers* and IAS 23 *Borrowing Costs*. (5 marks)

(b) Provide the accounting entries that would be required to record the contractual sale of an apartment block on 1 January 20X8 at the discounted amount over the two-year construction period. (3 marks)

(c) Discuss the way in which the chief accountant should have acted to ensure that he maintained ethical standards in dealing with the issues described. (10 marks)

Professional marks will be awarded in part (c) for the quality of the ethical discussion. (2 marks)

(20 marks)

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Question 3 begins on page 6.

Section B – BOTH questions are compulsory and MUST be attempted

3 Corbel Co trades in the perfume sector. It has recently acquired a company for its brand 'Jengi', purchased two additional brand names, and has announced plans to close its Italian stores. Corbel Co also opened a new store on a prime site in Paris. The current financial year end is 31 December 20X7.

Acquisition of Jengi Co

On 1 January 20X7, Corbel Co acquired 100% of Jengi Co. Both companies operate in the perfume sector. Corbel Co intends to merge the manufacture of Jengi Co's products into its own facilities and close Jengi Co's manufacturing unit. Jengi Co's brand name is well known in the sector, retailing at premium prices, and therefore, Corbel Co will continue to sell products under the Jengi brand name after its registration has been transferred and its manufacturing units have been integrated. The directors of Corbel Co believe that most of the value of Jengi Co was derived from the brand and there is no indication of the impairment of the brand at 31 December 20X7.

Acquisition of perfume brands

In addition to now owning the Jengi Co brand, Corbel Co has acquired two other perfume brand names to prevent rival companies acquiring them. The first perfume (Locust) has been sold successfully for many years and has an established market. The second is a new perfume which has been named after a famous actor (Clara) who intends to promote the product. The directors of Corbel Co believe that the two perfume brand names have an indefinite life.

Plan to close and sell stores

Corbel Co approved and announced a plan to close and sell all six Italian stores on 31 December 20X7. The six stores will close after a liquidation sale which will last for three months. Management has committed to a formal plan for the closure of the six stores and has also started an active search for a single buyer for their assets. The stores are being closed because of the increased demand generated by Corbel Co's internet sales.

A local newspaper has written an article suggesting that up to 30 stores may be closed with a loss of 500 jobs across the world, over the next five years. The directors of Corbel have denied that this is the case.

Corbel Co's primary store

Corbel Co's primary store is located in central Paris. It has only recently been opened at a significant cost with the result that management believes it will make a loss in the current financial year to 31 December 20X7. This loss-making is not of concern as the performance is consistent with expectations for such a new and expensive store and management believes that the new store will have a positive effect on Corbel Co's brand image.

If impairment testing of the primary store were to be required, then Corbel Co would include the cash flows from all internet sales in this assessment. The goods sold via the internet are sourced from either Corbel Co's central distribution centre or individual stores. Internet sales are either delivered to the customer's home or collected by the customer from the store supplying the goods.

Required:

(a) **Describe the main challenges in recognising and measuring intangible assets, such as brands, in the statement of financial position.** (5 marks)

(b) **Discuss the following accounting issues relating to Corbel Co's financial statements for the year ended 31 December 20X7 in accordance with IFRS standards:**

(i) **whether the Jengi Co brand name will be accounted for separately from goodwill on acquisition and whether it should be accounted for as a separate cash generating unit after the integration of the manufacturing units;** (4 marks)

(ii) **how to account for intangible assets with an indefinite life and whether the Locust and Clara perfume brand names can be regarded as having an indefinite life;** (6 marks)

(iii) **how to account for the proposed closure of the six stores and the suggested closure of the remaining stores; and** (6 marks)

(iv) **whether the primary store should be tested for impairment at 31 December 20X7 and whether the internet sales can be attributed to this store.** (4 marks)

(25 marks)

4 Handfood Co is a small and medium-sized enterprise (SME) which has introduced a benefit to encourage employees to remain with the entity. The company's financial year end is 31 December and it prepares its financial statements using IFRS standards but is interested in the differences with IFRS for SMEs.

Employee benefit

On 1 January 20X2, Handfood Co introduced an additional benefit to encourage employees to remain in its employment for at least five years. Handfood Co has promised its employees a lump-sum benefit, payable on 1 January 20X7, which is equal to 1% of their salary at 31 December 20X6, provided they remain employed until that date.

The current salaries of employees on 1 January 20X2 are $1·1 million per annum. The directors of Handfood Co have used the following assumptions:

– Salaries for year ended 31 December 20X2 will remain at $1·1 million.
– Salaries should increase by 3% each year from 1 January 20X3.
– There is a 75% probability that all employees will still be employed by Handfood Co at 31 December 20X6.

The discount rate is 5% per year.

Handfood Co recognises actuarial gains and losses in other comprehensive income. Interest is recognised by Handfood Co on an annual basis. Handfood Co uses the projected unit credit method to measure its defined benefit obligation which means that the current service cost is the increase in the present value of the future defined benefit liabilities. The benefit will be payable from the balance on Handfood Co's business bank account at 1 January 20X7.

Present value factors	5%
Periods (years)	
4	0·823
5	0·784

Required:

It can be argued that small and medium-sized enterprises (SMEs) face financing difficulties because there is serious information asymmetry between SMEs and investors. Information asymmetry, in the context of SMEs, means that the SME has access to relevant information, while the investor suffers from a lack of relevant information. It can be argued that IFRS for SMEs decreases information asymmetry between the entity and investors.

Where SMEs lead in product and service innovation, they can also lead in innovation for integrated reporting. There is a clear, concise and persuasive case for why SMEs and their stakeholders stand to benefit greatly by using integrated reporting.

(a) (i) Discuss the nature of IFRS for SMEs and the principal differences between IFRS for SMEs and full IFRS standards. (4 marks)

(ii) Discuss the effect that information asymmetry can have on the decision to invest in SMEs. (4 marks)

(iii) Discuss how integrated reporting could help SMEs better understand and better communicate how they create value to investors. (5 marks)

Note: you do not need to refer to any information relating to Handfood Co in your answer to part (a).

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

(b) (i) Discuss, with suitable calculations, the principles of how Handfood Co should account for the current service cost of its additional employee benefit for the year ended 31 December 20X2. (6 marks)

(ii) Discuss the impact on the additional employee benefit for the year ended 31 December 20X3 if Handfood Co were to take into account the following changes in assumptions:

– an increase in employees' salaries above 3% per annum; and
– a decrease in the probability of employees leaving the company.

Note: there is no need to provide any calculations in your answer to (b)(ii). (4 marks)

(25 marks)

End of Question Paper